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Court of Appeals No. 59477-0-I
King County Superior Court No. 05-2-08240-2 KNT

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

SOUND INFINITI, INC., d/b/a INFINITI OF KIRKLAND, a Washington corporation; ex rel AFSHIN PISHEYAR, a shareholder thereof; INFINITI OF TACOMA AT FIFE, INC., a Washington corporation, ex rel AFSHIN PISHEYAR, a shareholder thereof; S&I OF WA L.L.C., a Washington limited liability company, ex rel AFSHIN PISHEYAR, a member thereof; RDA PROPERTIES, LLC, a Washington limited liability company, ex rel AFSHIN PISHEYAR, a member thereof; and AFSHIN PISHEYAR, an unmarried individual,

Appellant/Cross-Respondent,

v.

RICHARD M. SNYDER and JEANNE C. SNYDER, husband and wife, and their marital community; RICHARD M. SNYDER as Trustee of the SNYDER CHILDREN'S IRREVOCABLE TRUST FOR THE BENEFIT OF ZACHARY SNYDER and the SNYDER CHILDREN'S IRREVOCABLE TRUST FOR THE BENEFIT OF TRAVIS SNYDER; and DAVID HANNAH and MARTHA M. HANNAH, husband and wife, and their marital community,

Respondents/Cross-Appellants.

BRIEF OF APPELLANT/CROSS-RESPONDENT

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I. INTRODUCTION

Plaintiff Afshin Pisheyar, a minority shareholder, sued the majority shareholders of two closely held corporations alleging self-dealing and misuse of corporate assets by the majority shareholders. The Complaint listed derivative claims as well as individual claims. Approximately five months after the suit was filed, the majority shareholders used reverse stock splits to forcibly eliminate Pisheyar as a shareholder of both corporations. The majority shareholders then persuaded the trial court to dismiss the derivative claims, and the majority of Pisheyar's claim to damages, because he was no longer a shareholder. Moreover, the trial court held that Pisheyar's sole remedy for Defendants' use of the reverse stock splits was provided by RCW 23B.13.020, which limits a dissenting shareholder to receiving "fair value" for his shares, unless the action violates procedural requirements or is fraudulent.

The central issue, and an issue of first impression in Washington, is whether RCW 23B.13.020 eclipses a trial court's inherent authority to fashion appropriate equitable and monetary relief when a minority shareholder has been squeezed out of a corporation. Washington courts have traditionally protected minority shareholders from the misconduct of the majority by recognizing common law claims for breach of fiduciary duty and oppression of minority shareholders.

The trial court's ruling, however, eviscerates these common law protections. If affirmed, the trial court's ruling would allow majority

shareholders to eliminate minority shareholders whenever minority shareholders challenged the propriety of the majority shareholders' actions. Absent a procedural violation or fraud, the minority shareholder's sole recourse would be the valuation process in RCW 23B.13.020, as opposed to damages caused by majority shareholders' wrongful conduct. If affirmed, claims for breach of fiduciary duty and minority oppression would no longer be available to minority shareholders who have been forced out of a corporation.

In addition, the trial court's ruling transforms RCW 23B.13.020 from a statute originally intended to protect minority shareholders into a tool for facilitating the misconduct of the majority. Because that result contradicts the act's legislative history and a developing body of case law holding that statutes like RCW 23B.13.020 do not prohibit claims for breach of fiduciary duty and minority oppression, this Court should reverse the trial court's ruling.

The second issue is whether a shareholder has standing to maintain a shareholder derivative action when his shareholder status has been forcibly revoked after the commencement of litigation. The trial court held that Pisheyar lacked standing to pursue a shareholder derivative action after the reverse stock split divested him of his shares in the Corporations. Pisheyar urges this Court to adopt the position followed by Oregon courts and advocated by the American Law Institute and hold that ex-shareholders have standing throughout the course of litigation when their

failure to remain shareholders resulted from corporate action in which they did not acquiesce.

In addition, the trial court characterized most of Pisheyar's damages as deriving from his status as a shareholder and dismissed these claims as a matter of law. By incorrectly dismissing most of Pisheyar's damages as derivative, the trial court severely restricted his individual claims for breach of fiduciary duty and minority oppression.

For these reasons, Pisheyar requests that this Court reverse the trial court's rulings regarding RCW 23B.13.020, standing, and the characterization of his damages, so that Pisheyar may pursue his full range of remedies at trial.

II. ASSIGNMENTS OF ERROR

1. The trial court erred in holding that RCW 23B.13.020, absent procedural violations or fraud, provides the exclusive remedy for Defendants' use of reverse stock splits to eliminate Plaintiff as a minority shareholder of both Corporations.

2. The trial court erred in granting Defendants' motion for reconsideration dismissing that part of Plaintiff's minority oppression claim that relied upon Defendants' use of reverse stock splits to eliminate Plaintiff as a minority shareholder of both Corporations.

3. The trial court erred in granting Defendants' motion for reconsideration dismissing that part of Plaintiff's breach of fiduciary duty

claim that relied upon Defendants' use of reverse stock splits to eliminate Plaintiff as a minority shareholder of both Corporations.

4. The trial court erred in granting Defendants' motion for reconsideration dismissing that part of Plaintiff's breach of contract claim that relied upon Defendants' use of reverse stock splits to eliminate Plaintiff as a minority shareholder of both Corporations.

5. The trial court erred in granting Defendants' motion for reconsideration dismissing Plaintiff's shareholder derivative actions for lack of standing.

6. The trial court erred in dismissing Plaintiff's claim to damages resulting from reduced corporate profit, increased corporate expenses, or decreased dividend distribution.

7. The trial court erred in limiting Plaintiff's damages to the "alleged deprivation of shareholder 'perquisites', such as demo cars, sports tickets, and the like."

8. The trial court erred by classifying as "derivative" damages incurred by Pisheyar individually as a minority shareholder.

9. The trial court erred in dissolving the Preliminary Injunction and entering findings of fact and conclusions of law in support thereof, thereby allowing the Defendants to institute reverse stock splits to eliminate Pisheyar as a minority shareholder.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Whether the trial court erred when it held as a matter of law that RCW 23B.13.020, absent a procedural violation or fraud, provided the exclusive remedy for a minority shareholder, thereby prohibiting common law claims for breach of fiduciary duty and oppression of a minority shareholder. (Assignments of Error 1, 2, 3, 4, 6, 7, 8, 9)

2. Whether the trial court erred when it held that Plaintiff could not claim, as a matter of law, that Defendants' use of reverse stock splits to eliminate Plaintiff as a shareholder constituted oppression of a minority shareholder. (Assignments of Error 1, 2, 4, 6, 7, 8, 9)

3. Whether the trial court erred when it held that Plaintiff could not claim, as a matter of law, that Defendants' use of reverse stock splits to eliminate Plaintiff as a shareholder constituted breach of fiduciary duty. (Assignments of Error 1, 3, 4, 6, 7, 8, 9)

4. Whether the trial court erred when it held that Plaintiff could not claim, as a matter of law, that Defendants' use of reverse stock splits to eliminate Plaintiff as a shareholder constituted breach of contract. (Assignments of Error 1, 4, 6, 7, 8, 9)

5. Whether the trial court erred in ruling that Plaintiff lacked standing to maintain his shareholder derivative claims after losing his shareholder status where Plaintiff was a shareholder when he filed the lawsuit and Plaintiff did not acquiesce in the corporate action that revoked his shareholder status. (Assignment of Error 5)

6. Whether the trial court erred in dissolving the Preliminary Injunction, which would have preserved the status quo until trial, given that the Defendants instituted the reverse stock split to eliminate Pisheyar as a minority shareholder after Pisheyar filed suit accusing the majority shareholders of breaching their fiduciary duty and improperly profiting at the Corporations' expense. (Assignments of Error 1, 2, 3, 6, 7, 8, 9)

7. Whether the trial court erred by characterizing Plaintiff's claim to damages resulting from reduced corporate profit, increased corporate expenses, or decreased dividend distribution as derivative and dismissing them on the basis of standing. (Assignments of Error 6, 7, 8)

IV. STATEMENT OF THE CASE

A. Pisheyar, Snyder and Hannah Go Into Business Together.

Plaintiff Afshin Pisheyar began his career as a salesman in one of Defendant Richard Snyder's automobile dealerships, and worked his way up to general manager. CP 562, RP 12-8-05, p. 62, l. 25–p. 63, l. 13.[1] After managing one of Snyder's dealerships for several years, Pisheyar told Snyder that he intended to start his own dealership. Snyder suggested instead that Pisheyar invest with him, and they eventually became joint owners of several new and used car dealerships. RP 12-8-05, p. 63, *l.* 5-13, CP 562.

In 1996, Defendant David Hannah joined Snyder and Pisheyar in forming Sound Infiniti, Inc. ("Sound Infiniti"), a new car dealership doing

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[1] Verbatim Reports of Proceeding (RP) 11-17-05 and 12-20-05.

business as Infiniti of Kirkland. RP 11-15-05, p. 71, l. 19-23. CP 606-612. Snyder owned 51 percent of the shares, Hannah 30 percent, and Pisheyar 19 percent.[2] CP 443.

The three men agreed to protect minority shareholders' investments by entering into a Buy-Sell Agreement which, among other things, prohibited the minority shareholders' termination as officers of the corporation in the absence of serious misconduct. CP 427. By 2004, the Sound Infiniti dealership had become one of the most profitable dealerships in the country. RP 11-15-05, p. 76, l. 17-22.

B. The Oral Agreement

Initially, Snyder was sole owner of the land leased by Sound Infiniti ("the Kirkland Property"). In January 2002, Snyder decided to sell the Kirkland Property to an outside buyer for five million dollars. CP 95, 2377-78. When Hannah and Pisheyar learned Snyder had signed a contract to sell the land, they were worried about the impact on Sound Infiniti. CP 95. They arranged to meet Snyder at Sound Mazda, a business owned by Pisheyar and Snyder, hoping to persuade Snyder to keep the Kirkland Property "in house." CP 95-96, 2380.

At the Sound Mazda meeting, Pisheyar suggested a plan that would allow Snyder to receive the full five million dollar price for the Kirkland property, while allowing Snyder to retain a one-third interest. CP

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[2] Shortly before this lawsuit was commenced, Snyder's and Hannah's interests were reversed, with Hannah acquiring a 51 percent interest, and Snyder 30 percent. *See* CP 256.

96-97, 2388. In return, Snyder would include Pisheyar and Hannah in future automobile dealerships that he obtained, and the three men would be core partners in both the ownership of the land and the businesses, following the Sound Infiniti model. *Id.; see also* CP 558-60.

Everyone agreed to this proposal as mutually beneficial: Snyder would receive the full sale price while retaining a one-third interest, and Hannah and Pisheyar would benefit from Snyder's ability to secure new dealerships (this oral agreement is hereafter referred to as the "Sound Mazda agreement"). CP 559-560. Pursuant to the Sound Mazda agreement, Snyder rescinded his contract with the outside buyer, and the three men obtained a loan that provided Snyder with the five million dollar purchaser price. CP 560, 576-96.

The following year, in accordance with the Sound Mazda agreement, the three of them formed Infiniti of Tacoma at Fife, Inc. ("Infiniti of Tacoma") to operate a new Infiniti dealership in Tacoma. CP 560. They also formed RDA Properties, LLC, to purchase, develop and lease the dealership property to Infiniti of Tacoma. CP 13. As agreed, Snyder held a majority interest in Infiniti of Tacoma, Pisheyar a 19% interest, and each of the three owned one-third of RDA Properties, LLC. CP 2526-29.

C. The Used Car Dealerships

Among the businesses jointly owned by Snyder and Pisheyar were several used car dealerships that were managed by Pisheyar. During the

economic downturn beginning in late 2001, these dealerships were not doing well, so Pisheyar did not take any salary for managing them. CP 2361-62. In 2003, Pisheyar approached Snyder and asked him to put more money into these companies so that Pisheyar could be compensated for his work. Snyder refused. CP 2362. The problem was ultimately resolved by Snyder's purchase of Pisheyar's interests in these businesses. *Id.*, CP 2605-2620.

D. The Exclusion of Pisheyar

By early 2004, Pisheyar realized Snyder and Hannah were excluding him from meetings and decision-making, no longer treating him as "part of the team." CP 16-20, 563-65. In April, he had his attorney write the corporations' attorney a letter addressing the issue. CP 2592-93. He also became concerned about Snyder's intentions with regard to an anticipated new Nissan dealership to be acquired by Snyder. CP 562-68, 2595. At the time, Pisheyar was unaware that in January of that year, Snyder and Hannah had secretly taken large loans from the Corporations to purchase land for the new Nissan dealership. CP 566, 683-86; RP 12-8-05, p. 101, *l.* 20–p. 102, *l.* 11.

In January 2005, Pisheyar finally learned from Hannah that Snyder had taken some $900,000 from the lines of credit of the Corporations. CP 681. Hannah also told Pisheyar that the shareholders would not receive their usual dividends, because the Corporations did not have sufficient funds available. CP 104, 564-68, 730-33. Pisheyar persisted in questioning

the apparent self-dealing, and finally learned that the Corporations' funds had been depleted to buy land for the new Nissan dealership, from which he had been excluded. CP 562, 564. Pisheyar complained to the majority shareholders, but they failed to respond to his concerns. CP 2594-97.

E. Pisheyar Files Suit.

On March 9, 2005, Pisheyar filed suit against Snyder and Hannah, alleging both personal claims, and shareholder derivative claims on behalf of Sound Infiniti, Infiniti of Tacoma, and the two limited liability companies owned by the three of them. CP 1-11. Pisheyar alleged, *inter alia*, that the majority shareholders breached their fiduciary duties, and oppressed Pisheyar as a minority shareholder. The Defendants' motion to dismiss pursuant to CR 12(b)(6) was denied on July 1, 2005. CP 30-31.

F. The Majority Shareholders Retaliate.

About three weeks after the CR 12(b)(6) motion was denied, Snyder and Hannah notified Pisheyar of a future meeting of the directors of the Corporations to discuss "stock splits" and indemnification. CP 33, 38. Pisheyar understood that the majority shareholders wanted the Corporations to advance attorneys' fees to them to defend against the lawsuit. CP 33. However, it was not clear until he later attended the meeting that the majority shareholders did not intend to implement stock splits, but rather sought to eliminate him as a shareholder through "reverse stock splits." CP 33-35, 43-44.

After the meeting, Pisheyar moved to enjoin the majority shareholders from terminating his shareholder status and from advancing attorneys' fees. The court granted a preliminary injunction in September, 2005. CP 997-99. However, following an evidentiary hearing, the trial court dissolved the injunction on December 20, 2005. CP 160-161.

Snyder and Hannah then held special meetings of both Corporations on January 24, 2006, where they voted, over Pisheyar's opposition, to approve reverse stock splits. CP 173-74. The reverse stock splits resulted in Pisheyar being eliminated as a shareholder. The following week, the Defendants terminated Pisheyar's employment as an officer of Sound Infiniti. CP 250.

With the injunction dissolved, the Defendants billed the Corporations over $400,000 in attorneys' fees through December 2005. CP 233. Pisheyar, in effect, paid 19 percent, or over $76,000, as his distribution of Corporate profits was reduced by that sum for the Corporations to advance the attorney fees to the defendants. *Id.*

On February 27, Pisheyar sought to have the Court of Appeals review the ruling and reinstate the injunction preventing the reverse stock split. On May 17, 2006, the Court of Appeals declined review. (See Case No. 57803-I).

G. Claims Dismissed on Summary Judgment.

On February 14, 2006, the defendants moved to dismiss the shareholder derivative claims brought by Pisheyar "[b]ecause he is no

longer a shareholder and therefore has no standing to bring shareholder-based claims." CP 2070. Pisheyar responded that the shareholder derivative claims should not be dismissed because Pisheyar "challenges the propriety of the very action that would deprive him of shareholder status."[3] Meanwhile, Defendants filed a second motion to dismiss Pisheyar's "wrongful termination and other claims" based on the forced termination of his shareholder status. CP 2091-99.

On June 9, 2006, the trial court dismissed the derivative claims, holding that because Pisheyar had been eliminated as a shareholder of both Corporations, he no longer had standing to bring claims on their behalf. CP 309-311.

The majority shareholders also brought motions for summary judgment to dismiss Pisheyar's claims for oppression of a minority shareholder, wrongful termination, and all of his damage claims. CP 2266-83, 2091-2114, 2284-2301. Although Pisheyar argued that even if his employment as an officer arose from his status as a shareholder, it was not a derivative claim and his fellow shareholders had promised not to fire him without cause,[4] the trial court agreed with the majority shareholders and dismissed the wrongful termination claim.

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[3] Plaintiff's Opposition to Defendants' Motion to Dismiss All Shareholder Claims, p. 2, Appellant's Supplemental Clerk's Papers.

[4] Plaintiff's Memorandum in Opposition to Defendant's Six Motion for Partial Summary Judgment, p. 17, Appellant's Supplemental Clerk's Papers.

On December 6, 2006, the court declined to dismiss Plaintiff's claims for oppression of a minority shareholder and damages. CP 504-507. However, in response to a motion for reconsideration, the court reversed itself on December 29, 2006, and dismissed these claims with respect to the reverse stock split and damages the court characterized as arising out of Pisheyar's status as a shareholder or his termination as an officer. CP 508-510 (Appendix A). Instead, the court limited Pisheyar's damages to his loss of "'perquisites' such as demo cars, sports tickets, and the like." CP 509.

The parties did not learn of the court's order until a pre-trial conference on January 3, 2007, where the trial court explained:

> I concluded that no reasonable trier of fact, given the state of the law, could conclude that the reverse stock split would constitute minority oppression. However, I did feel that Mr. Pisheyar still should be permitted to proceed with minority oppression claims that were personal to himself such as his allegedly not being given equal status with the other shareholders or commensurate status I guess I should say for things like sporting tickets, demo cars and any other corporate perk.

RP 1-3-07, p. 20, *ll.* 5-14.

Defendants had not moved for summary judgment on Pisheyar's claims for conversion of corporate assets, breach of fiduciary duty, or breach of contract to maintain him as a director and Secretary of Sound Infiniti. CP 322-23. However, the court's characterization of permissible remedies for oppression of a minority shareholder effectively dismissed Pisheyar's remedy for these other claims. The court's order states:

A. The following claims for "minority shareholder oppression" are dismissed:

1) Plaintiff's claim for damages arising from Defendant's implementation of the reverse stock split . . .

2) Plaintiff's claims for damages arising out of his claims that defendants' conduct resulted in reduced corporate profits, or increased corporate expenses, and therefore in reduced dividend distributions. The court finds that such claims are derivative in nature, and that plaintiff lacks standing to assert them.

3) Plaintiff's claim for damages arising out of his wrongful termination claim, which was dismissed earlier on summary judgment.

CP 509.

The parties moved to certify the issue for appeal. RP 1-3-07, p.21, *l.* 19-p.20, *l.* 13. Noting the absence of Washington precedent, the court agreed. RP 1-3-07, p. 33, *l.* 6-16. Plaintiff filed and served an initial notice to preserve its appeal on January 29, 2007. CP 511-15. After the trial court certified certain orders for appeal, Plaintiff filed a second notice, CP 530-38, and defendants also moved for discretionary review. CP 539-56. This court then granted plaintiffs' motion to consolidate the two appeals.

Commissioner Craighead granted discretionary review of the following issues:

1. Does RCW 23B.13.020 provide an exclusive remedy to a minority shareholder when a closely-held corporation implements a reverse stock split?
2. Were Pisheyar's derivative claims properly dismissed?
3. Should Pisheyar's "perquisite" claims also have been dismissed as derivative?

Decision Granting Review, June 19, 2007.

V. SUMMARY OF ARGUMENT

In every American jurisdiction, shareholders of corporations that engage in certain fundamental corporate transactions, such as a merger or reverse stock split, have the right to dissent from the transaction and receive payment of the appraised fair value of their shares. These statutory protections are commonly called "dissenter's rights" or the "appraisal remedy."

Historically, these dissenter's rights statutes were intended to protect minority shareholders and to complement the longstanding common law protections for shareholders. These common law protections predate the enactment of dissenter's rights and have evolved independently of the statutory remedy.

The common law in Washington, for example, recognizes that majority shareholders owe a fiduciary duty to minority shareholders. This fiduciary duty is enhanced in a closely held corporation and requires a duty of utmost good faith and loyalty. Washington's common law also protects minority shareholders from the oppressive actions of the majority.

Against this backdrop of common law protections, Washington enacted its appraisal remedy, RCW 23B.13.020, in 1989. This statute provides that a shareholder who dissents from certain corporate actions, such as a reverse stock split, may receive fair value for his or her shares. The statute also provides that the dissenting shareholder may not challenge the corporate action unless the action violates procedural requirements or is fraudulent. The Official Legislative History to RCW 23B.13.020,

however, recognizes that the statute does not limit a court's freedom to act if the corporation has violated a fiduciary duty and notes that the appraisal remedy may not be adequate in the presence of self dealing.

Indeed, numerous jurisdictions have held that dissenter's rights were never intended to foreclose common law claims for breach of fiduciary duty or minority shareholder oppression. On June 27, 2007, for example, the Supreme Court of New Mexico held that New Mexico's appraisal statute, which is very similar to RCW 23B.13.020, did not preclude a claim for breach of fiduciary duty. This case, which is discussed in section VI.C.3 below, reasoned that to prohibit these common law claims would not only subvert the original purpose of the appraisal remedy to protect minority shareholders, but also facilitate the oppressive actions of the majority. Recognizing that result would be anathema to the legislative intent, and relying on several other factors, the New Mexico Supreme Court unanimously held that its appraisal statue did not prohibit a breach of fiduciary duty claim.

Here, however, the trial court held that RCW 23B.13.020 provided the exclusive remedy, and that a claim for oppression of minority shareholder was not available to prevent his forcible ouster by the majority. The trial court implicitly held that Pisheyar could not claim that the Defendants' implementation of reverse stock splits constituted a breach of fiduciary duty or a breach of conduct, or was otherwise improper.

Not only does the trial court's ruling ignore the long-standing common law protections for minority shareholders, but it also contradicts the original purpose of RCW 23B.13.020 to protect minority shareholders. The trial court's ruling also ignores the legislative history behind the act, the extra scrutiny given to conflict of interest transactions, and the growing trend of recent decisions from other jurisdictions which have concluded that the statutory rights granted to dissenting shareholders do not foreclose claims for breach of fiduciary duty or minority oppression.

Moreover, the trial court compounded its error by holding that because Pisheyar had been stripped of his shareholder status, he no longer had standing to pursue any damages arising out of his shareholder status. Pisheyar had standing when he initiated this suit, and because he did not acquiesce in the decision to eliminate his shareholder status, he should have standing to maintain his shareholder claims throughout the suit.

VI. ARGUMENT

A. The Standard of Review Is De Novo.

The December 29, 2006 Order grants in part Defendants' motion for reconsideration of the trial court's order denying summary judgment on Plaintiff's minority shareholder oppression and damages claims. CP 508-10. The standard of review for a summary judgment order is de novo. *Berrocal v. Fernandez,* 155 Wn.2d 585, 590, 121 P.3d 82 (2005).

B. The Common Law Protects Minority Shareholders by Allowing Claims Against Majority Shareholders for Breach of Fiduciary Duty and Oppression of Minority Shareholders.

1. The Fiduciary Duty Owed Minority Shareholders Is Enhanced in a Closely Held Corporation.

Washington law recognizes that majority shareholders owe a fiduciary duty to minority shareholders. *Wool Growers Service Corp. v. Ragan*, 18 Wn.2d 655, 691, 140 P.2d 512 (1943) ("majority stockholders occupy a fiduciary relation toward the minority stockholders.") This fiduciary duty incorporates a duty of good faith and fair dealing towards minority shareholders. R.J. McGaughey, *Washington Corporate Law Handbook* § 7.10 at 143 (1993) (hereinafter "McGaughey"); *Hay v. Big Bend Land Co.*, 32 Wn.2d 887, 897, 204 P.2d 488 (1949) ("The principle that a majority of the stockholders must, at all times, exercise good faith toward the minority stockholders is well recognized.")

Similarly, Washington law provides that corporate officers and directors owe a fiduciary duty of good faith and loyalty to the corporation they serve and its shareholders. *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wn. App. 502, 509, 728 P.2d 597 (1986) (directors and officers are fiduciaries of the corporations they serve and are not permitted to retain any personal profit or advantage); McGaughey, § 5.13 at 86-88 (noting that "courts will vigorously scrutinize transactions involving conflicts of interest or self-dealing."). Majority shareholders and directors act in bad faith when their actions benefit them, rather than the corporations they serve and the remaining shareholders. *Interlake Porsche & Audi, Inc.*, 45 Wn. App. at

509.; *Hayes Oyster Co. v. Keypoint Oyster Co.*, 64 Wn.2d 375, 381, 391 P.2d 979 (1964) (noting fiduciary duty violated when officers or directors "directly or indirectly acquire a profit for themselves or acquire any other personal advantage").

In the case at hand, Pisheyar has alleged that the majority shareholders, who are also directors, acted in bad faith by taking actions to benefit themselves, at the expense of the Corporations and their shareholders.

The fiduciary duties of majority shareholders and directors are enhanced in a closely held corporation. A "closely held corporation" or a "close corporation" means a corporation with few shareholders, who are typically involved as owners and managers, and for which there is usually no ready market for the sale of the corporation's shares. *Rogers Walla Walla, Inc. v. Ballard*, 16 Wn. App. 81, 89 n.9, 553 P.2d 1372 (1976).

The duty owed between shareholders in closely held corporations has been described as similar to the heightened fiduciary duty that exists among partners, a duty of utmost good faith and loyalty. 2 F. H. O'Neal and Robert B. Thompson, *O'Neal's Oppression of Minority Shareholders and LLC Members* §§ 7:04, 7:05 (2006); *Shermer v. Baker*, 2 Wn. App. 845, 472 P.2d 589 (1970) (majority shareholders stand in a fiduciary relation to corporation and its shareholders and owe a duty to minority not to profit at their expense). The Corporations at issue in this case are closely held corporations.

2. Minority Shareholder Oppression in Washington.

In addition to the remedies available for breach of fiduciary duty, courts at common law could use their equitable power to liquidate the assets and business of a corporation on a showing of irreparable injury to the shareholders and the corporation due to gross or fraudulent mismanagement. *Henry George & Sons, Inc. v. Cooper-George, Inc.*, 95 Wn.2d 944, 948, 632 P.2d 512 (1981). Washington eventually adopted the Washington Business Corporation Act, which allows judicial dissolution when the "directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, *oppressive*, or fraudulent." RCW 23B.14.300(2)(b) (emphasis added). While RCW 23B.14.300 refers only to dissolution, Washington courts retain the authority to fashion alternative remedies short of dissolution to redress oppressive conduct by those in control of a corporation. *Scott v. Trans-System, Inc.*, 148 Wn.2d 701, 717-18, 64 P.3d 1 (2003).

Because RCW 23B.14.300 does not define "oppressive" action, Washington courts have adopted two tests from other jurisdictions to define oppressive conduct: the "reasonable expectations" and "burdensome, harsh and wrongful conduct" tests. *Scott*, 148 Wn.2d at 711. As explained below, the reasonable expectations test is the most appropriate standard for this case.

The reasonable expectations test, which is the predominant test across the country, defines oppression as "a violation by the majority of the reasonable expectations of the minority." *Scott,* 148 Wn.2d at 711.

According to *Scott*, reasonable expectations are "'those spoken and unspoken understandings on which the founders of a venture rely when commencing the venture.'" *Id.* (quoting *Robblee v. Robblee,* 68 Wn. App. 69, 76, 841 P.2d 1289 (1992)). *Scott* noted that:

> Application of the reasonable expectations test is most appropriate in situations where the complaining shareholder was one of the original participants in the venture—one who would have committed capital and resources.

Scott, 148 Wn.2d at 711.

Here, Pisheyar, who was an original member of both Corporations, contributed both capital and resources to their formation. Thus, he had a reasonable expectation that he would not be forced out of the Corporations and the violation of this expectation constituted oppression.

3. A Reverse Stock Split May Be an Instrument for Oppressing Minority Shareholders.

In the case at hand, both Corporations used reverse stock splits to forcibly remove Pisheyar as a shareholder. A "reverse stock split" occurs when a number of a corporation's shares are combined into one share, which may result in a minority shareholder being left with a fractional share. *Lerner v. Lerner Corp.*, 750 A.2d 709, 718 (Md. Ct. Spec. App. 2000) For example, Pisheyar had 19 shares in Inifinti of Tacoma prior to the reverse stock split. Infiniti of Tacoma then reduced the number of outstanding shares from 100 to 4. CP 48-49. This 25-to-1 reverse stock split left Pisheyar with less than one share, or a fractional share.

For fractional shares, Washington law permits a corporation either to "[i]ssue fractions of a share or pay in money the value of fractions of a

share." RCW 23B.06.040(1)(a). Thus, in a reverse stock split, a Washington corporation does not have to eliminate a minority shareholder with a fractional share, but can simply issue a fractional share. Here, both Corporations, over Pisheyar's objections, chose to remove him as a shareholder by purchasing his fractional shares. CP 34-35, 48, 73-74.

When used to eliminate a minority shareholder, a reverse stock split can constitute oppression:

> The weight of authority indicates that the use of a reverse split and elimination of fractional shares for the purpose of eliminating minority stockholders may raise fairness, business purpose, or other similar issues justifying judicial intervention.

Lerner, 750 A.2d at 720 (citations omitted); *see also Applebaum v. Avaya, Inc.*, 805 A.2d 209, 218 (Del. Ch. 2002) (noting that "reverse stock splits can be employed as instruments of oppression").

The use of a reverse stock split as a tool of oppressing or freezing out a minority shareholder is particularly egregious in a closely held corporation, *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 328 N.E.2d 505, 511 (Mass. 1975).

Similarly, a breach of fiduciary duty occurs when the majority's control of a closely held corporation is used to deny a minority shareholder's participation in the corporation:

> Majority or controlling shareholders breach such fiduciary duty to minority shareholders when control of the close corporation is utilized to prevent the minority from having an equal opportunity in the corporation.

Crosby v. Beam, 548 N.E.2d 217, 221 (Ohio 1989) (citations omitted). Thus, a majority shareholder's use of a reverse stock split to "freeze out" a minority shareholder in a closely held corporation may be oppressive and a breach of fiduciary duty.

Nevertheless, the trial court held that Pisheyar could not allege that the defendants' implementation of the reverse stock splits constituted a breach of fiduciary duty or oppression. Instead, the trial court ruled that the appraisal rights in RCW 23B.13.020 provided the exclusive remedy for the implementation of the reverse stock splits. CP 509. The trial court effectively gutted Pisheyar's oppression claim (and his breach of fiduciary duty claim) by limiting his remedy to damages arising from the "alleged deprivation of shareholder 'perquisites,', such as demo cars, sports tickets, and the like." CP 509. Furthermore, the trial court concluded that because Pisheyar was no longer a shareholder, he lacked standing to pursue "derivative" damages caused by Defendants' actions that resulted in reduced corporate profits or increased corporate expenses. CP 509.

Not only did the trial court's ruling ignore the common law protections afforded minority shareholders, but it also ignored the purpose of RCW 23B.13.020 and its legislative history. As explained in the following section, RCW 23B.13.020 was enacted to protect minority shareholders and *not* to make it easier for the majority to oppress them.

C. The Appraisal Right in RCW 23B.13.020 Is a Shield To Protect Minority Shareholders and Complement the Common Law Protections for Minority Shareholders, and Not a Tool To Facilitate the Misconduct of the Majority.

In 1946, the American Bar Association's Corporate Law Committee first published the Model Business Corporation Act (MBCA). Since that time, the Committee has revised the Act on several occasions. In 1984, the Committee published the Revised Model Business Corporation Act (RMBCA). *Ballard Square Condominium Owners Ass'n v. Dynasty Const. Co.*, 126 Wn. App. 285, 292 n.24, 108 P.3d 818 (2005).

In 1989, the Washington Legislature repealed its prior corporations act and enacted chapter 23B RCW, including RCW 23B.13.020. In its comments to chapter 23B, the Legislature stated that it substantially relied on the provisions, purposes, and principles of the 1984 RMBCA. *Id.* at 292-93.

In its current form, RCW 23B.13.020 states:

> (1) A shareholder is entitled to dissent from, and obtain payment of the fair value of the shareholder's shares in the event of, any of the following corporate actions:
>
> . . .
>
> (d) An amendment of the articles of incorporation, whether or not the shareholder was entitled to vote on the amendment, if the amendment effects a redemption or cancellation of all of the shareholder's shares in exchange for cash or other consideration other than shares of the corporation; or
>
> . . .
>
> (2) A shareholder entitled to dissent and obtain payment for the shareholder's shares under this chapter may

> not challenge the corporate action creating the shareholder's entitlement unless the action fails to comply with the procedural requirements imposed by this title, RCW 25.10.900 through 25.10.955, the articles of incorporation, or the bylaws, or is fraudulent with respect to the shareholder or the corporation.

RCW 23B.13.020(1)–(2) (Appendix B).

A shareholder who disagrees with the corporation's view of fair value for the shareholder's shares may inform the corporation of the shareholder's estimate of fair value. RCW 23B.13.280. If the corporation disagrees with shareholder's estimate, the corporation may commence an appraisal action in superior court. RCW 23B.13.300. These statutory provisions, allowing a shareholder to dissent from a merger or a reverse stock split and receive the appraised fair value for his or her shares, are commonly called "dissenter's rights" or the "appraisal remedy." *Pueblo Bancorporation v. Lindoe, Inc.*, 63 P.3d 353, 358 (Colo. 2003).

1. Historically, the Dissenter's Rights in RCW 23B.13.020 Were Intended To Protect Minority Shareholders.

At common law, unanimous shareholder approval was required before a corporation could engage in a fundamental corporate transaction. *Voeller v. Neilston Warehouse Co.,* 311 U.S. 531, 536 n.6, 61 S. Ct. 376, 85 L.Ed. 322 (1941); Barry M. Wertheimer, *The Purpose Of The Shareholders' Appraisal Remedy*, 65 Tenn. L. Rev. 661, 662 (1998) (hereinafter "Wertheimer"). As a result, individual shareholders had the ability to veto fundamental corporate changes. Wertheimer at 662. To prevent an individual shareholder from arbitrarily blocking these changes,

state legislatures amended corporate statutes to permit such transactions by a majority vote of shareholders. Wertheimer at 662; *Voeller,* 311 U.S. at 536 n.6. As the *Voeller* court noted, however, allowing a majority of shareholders to approve fundamental corporate changes "opened the door to victimization of the minority. To solve the dilemma, statutes permitting a dissenting minority to recover the appraised value of its shares, were widely adopted." *Voeller,* 311 U.S. at 536 n.6.

As Professor Wertheimer stated:

> Once shareholders lost the right to veto fundamental changes, it was possible for shareholders to find themselves involuntarily holding an investment in an entity vastly different from the one originally contemplated. For example, if a majority of a corporation's shareholders approved a merger with another entity, a shareholder voting against that transaction would, in the absence of an appraisal remedy, have no choice but to remain a shareholder in the merged entity. The appraisal remedy allows the shareholder a "way out" of an investment involuntarily altered by a fundamental corporate change.

Wertheimer at 662-63 (footnotes omitted).

Thus, when corporations were granted the right to engage in mergers and other fundamental transactions by majority, rather than unanimous, shareholder approval, minority shareholders were granted the right to dissent from such transactions and to receive the appraised fair value of their shares. Thus, "[t]he original goal of the appraisal remedy was to protect minority shareholders from being stuck in illiquid investments not of their choice." *Id.* at 680. Today, every American jurisdiction has some form of statutory appraisal rights. *Id.* at 661 n.2.

2. The Legislative History of RCW 23B.13.020 Establishes that Courts Retain Independent Authority To Remedy Shareholder Misconduct.

In support of its holding that RCW 23B.13.020 provided the exclusive remedy, the trial court quoted only one phrase in the Official Legislative History to the act for the proposition that the dissenters' right statute is "the exclusive remedy unless the transaction fails to comply with procedural requirements or is 'fraudulent'." CP 509.[5] Because Pisheyar had not alleged fraud or procedural violations, the court held that as a matter of law the implementation of the reverse stock split could not constitute oppression. RP 1-3-07 p.18, *ll* 4-7; CP 509.

The trial court's selective quotation from the Official Legislative History for RCW 23B.13.020 is taken out of context. Indeed, the paragraph *surrounding* that quotation establishes that the Legislature recognized a court's authority to remedy misconduct by majority shareholders apart from the appraisal remedy in RCW 23B.13.020:

> Proposed subsection 13.02(b) basically adopts the New York formula as to exclusivity of the dissenters' remedy of this chapter. The remedy is the exclusive remedy unless the transaction fails to comply with procedural

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[5] The trial court also relied upon *Matthews v. Wenatchee Heights Water*, 92 Wn. App. 541, 963 P.2d 958 (1998). CP 509. The Matthews case, however, provides little assistance in analyzing RCW 23B.13.020. First, the case simply states without analysis that the statute provides the exclusive remedy absent fraud, citing *Matteson v. Ziebarth*, 40 Wn.2d 286, 297, 242 P.2d 1025 (1952). *Matthews*, 92 Wn. App. at 555. The *Matteson* case was decided long before RCW 23B.13.020 was enacted. Thus, as Commissioner Craighead concluded, *Matteson* is not helpful. Commissioner's Ruling, dated June 19, 2007, at p. 6 n.3.

> requirements or is "fraudulent.". . . **If the corporation attempts an action in violation of the corporation law on voting, in violation of clauses in articles of incorporation prohibiting it, by deception of shareholders, or in violation of a fiduciary duty–to take some examples–the court's freedom to intervene should be unaffected by the presence or absence of dissenters' rights under this chapter.** Because of the variety of situations in which procedural defects and fraud may appear, this section makes no attempt to specify particular illustrations. **Rather, it is designed to recognize and preserve the principles that have developed in the case law of Delaware, New York and other states with regard to the effect of dissenters' rights on other remedies of dissident shareholders. See Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) (appraisal remedy may not be adequate "where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross or palpable overreaching are involved");** Walter J. Schloss Associates v. Arkwin Industries, Inc., 455 N.Y.S.2d 844, 847-52 (App. Div. 1982) (dissenting opinion), reversed, with adoption of dissenting opinion, 460 N.E.2d 1090 (Ct. App. 1984). See also Vorenberg, "Exclusiveness of the Dissenting Stockholders' Appraisal Right," 77 HARV. L. REV. 1189 (1964).

The Official Legislative History to RCW 23B.13.020, Senate Journal 51st Legis. 3087-88 (1989), at 13.020-3 to 13.020-4 (emphasis added) (attached as Appendix B).

Elsewhere in the Official Legislative History, the Legislature noted that providing dissenter's rights for reverse stock splits in RCW 23B.13.020(1)(d) "would afford minority shareholders *additional* protection from such transactions, while enhancing the majority's freedom to make such changes." Official Legislative History (App. A at 13.020-3) (emphasis added). Thus, RCW 23B.13.020(1)(d) was intended to provide

minority shareholders facing a reverse stock split with additional protection; it was never intended to facilitate the oppression of the minority shareholders.

Moreover, in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), cited with approval in the Official Legislative History, the Delaware Supreme Court noted that the statutory remedy of appraisal for a dissenting shareholder may not always be appropriate:

> While a plaintiff's monetary remedy ordinarily should be confined to the more liberalized appraisal proceeding herein established, we do not intend any limitation on the historic powers of the Chancellor to grant such other relief as the facts of a particular case may dictate. **The appraisal remedy we approve may not be adequate in certain cases, particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved.** [citation omitted] Under such circumstances, the Chancellor's powers are complete to fashion any form of equitable and monetary relief as may be appropriate, including rescissory damages.

Weinberger, 457 A.2d at 714 (emphasis added). In addition, *Weinberger* held that where corporate directors stand on both sides of a transaction, they have the burden of demonstrating "entire fairness." *See id.* at 710-11.

Here, the appraisal remedy afforded by RCW 23B.13.020 does not adequately compensate Pisheyar for the damages he has suffered as the result of the Defendants' conduct, such as decreased shareholder distributions resulting from Snyder's removal of a substantial sum of money from the Corporations in 2004; nor does it address Pisheyar's

elimination as a shareholder in retaliation for the claims he asserted. As *Weinberger* notes, a court has the authority to remedy these damages apart from any statutory appraisal remedy.

3. The *McMinn* Case Provides a Blueprint for Resolving the Case at Hand.

Every American jurisdiction has some form of appraisal rights. Wertheimer at 661 n.2. New Mexico law, for example, provides that:

> A. Any shareholder of a corporation may dissent from, and obtain payment for the shareholder's shares in the event of, any of the following corporate actions:
>
> . . .
>
> (5) any other corporate action taken pursuant to a shareholder vote with respect to which the articles of incorporation, the bylaws or a resolution of the board of directors directs that dissenting shareholders shall have a right to obtain payment for their shares.

N. M. Stat. Ann. § 53-15-3(A) (Michie 1978). Subsection (5) would apply to a reverse stock split where the corporation purchased fractional shares.

New Mexico also provides that these appraisal rights are the exclusive remedy for a dissenting shareholder:

> A shareholder of a corporation who has a right under this section to obtain payment for his shares shall have no right at law or in equity to attack the validity of the corporate action that gives rise to his right to obtain payment, nor to have the action set aside or rescinded, except when the corporate action is unlawful or fraudulent with regard to the complaining shareholder or to the corporation.

N. M. S. A. 1978, § 53-15-3(D).

Thus, the New Mexico statute is very similar to RCW 23B.13.020. Indeed, both acts derive from the Model Business Corporations Act. *See* McGaughey, § 8.04 at 162 ("RCW 23B.13.020(2) is substantially the same as the Revised Model Business Corporations Act § 13.02(b)"); *McMinn v. MBF Operating Acquisition Corp.*, 164 P.3d 41, 49-50 (N.M. 2007) (Appendix C).

Recently, in a case similar to this one, the New Mexico Supreme Court held that statutory appraisal rights were not intended to be the exclusive remedy for a minority shareholder who lost his shareholder status pursuant to a "freeze out" merger involving two closely held corporations. As a result, *McMinn* held that the appraisal remedy did not foreclose the plaintiff "seeking compensatory damages for breach of fiduciary duty." *McMinn*, 164 P.3d at 57.

The *McMinn* case provides an excellent blueprint for resolving the instant case. In *McMinn*, the plaintiff was a minority shareholder who lost his interest in a closely held corporation subsequent to the majority shareholders' use of a "freeze out" merger transaction. *McMinn*, 164 P.3d at 42. In the freeze out merger, the two controlling shareholders first established a shell corporation whose sole purpose was to merge with the existing corporation. *Id.* The two majority shareholders then caused the shell corporation to merge with the prior corporation, with one condition to the merger being the "freeze out" of the minority shareholder by a forced cash purchase of the minority shareholder's shares. *Id.* The effect

of the freeze out merger in *McMinn* is akin to the reverse stock split in the case at hand.

The plaintiff in *McMinn* filed suit against the corporation and its two majority shareholders for breach of fiduciary duty, oppressive conduct and tort. *McMinn*, 164 p.3d at 44. McMinn's claims were based upon defendants' conduct before, during and after the merger. *Id.* The corporation moved for summary judgment, arguing that the appraisal statute provided the exclusive remedy for the plaintiff. *McMinn*, 164 P.3d at 44. The judge denied the motion. *Id.*

At trial, the jury found that the defendant corporation had breached its fiduciary duty towards McMinn and awarded the plaintiff compensatory and punitive damages. *McMinn*, 164 P.3d at 44-5. On appeal, the Court of Appeals reversed the jury verdict, ruling that New Mexico's appraisal statute provided the exclusive remedy for a dissenting shareholder. *McMinn*, 164 P.3d at 45. In a unanimous opinion, however, the New Mexico Supreme Court reversed the Court of Appeals and affirmed the jury verdict. *Id.* at 43.

The *McMinn* court began its analysis of the key issue in the case, namely, the exclusivity of the appraisal remedy, by recognizing the fiduciary duties shareholders have to each other in a closely held corporation. *McMinn*, 164 P.3d at 46. *McMinn* noted that New Mexico, like Washington, recognizes fiduciary duties "between shareholders of a close corporation outside of the corporation statute's provision for relief from illegal, oppressive or fraudulent conduct." *Id.*

Furthermore, these fiduciary duties are subject to greater scrutiny where conflict of interest issues implicate the duty of loyalty. *McMinn*, 164 P.3d at 46-7. A conflict of interest arose in *McMinn* because the majority shareholders controlled both sides of the transaction—the original corporation and the subsequent shell corporation—that benefited the controlling shareholders. *Id.* In support of this position, the *McMinn* court cited *Weinberger*, 457 A.2d at 710 ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.") *McMinn*, 164 P.3d at 47.

Next, the *McMinn* court considered whether New Mexico's appraisal statute provided the exclusive remedy for a dissenting shareholder, noting that historically appraisal statutes "were designed to protect dissenting shareholders." *McMinn*, 164 P.3d at 48. In addition, at the time appraisal statutes were adopted, the common law provided "substantial prohibitions" against minority shareholders being forced out of corporations. *Id.* Thus, when enacted, the appraisal statutes "'reflected the more limited reach of majority power.'" *Id.* (citation omitted).

Today, however, *McMinn* noted that "mergers are often used solely to eliminate minority shareholders." *McMinn*, 164 P.3d at 49. The *McMinn* court concluded that the different way fundamental corporate changes are being used required a different approach to the exclusivity of the appraisal remedy. *Id.* As a result, *McMinn* held that the exclusivity provision in the appraisal statute, which was designed for arms-length

mergers, did not apply to the use of a freeze out merger in a closely held corporation where the majority shareholders stood on both sides of the transaction. *McMinn*, 164 P.3d at 49-51.

In addition, *McMinn* noted that the term "fraudulent" as used in the Model Act was not limited to common law fraud, but also encompassed a variety of acts including breach of fiduciary duty. *McMinn*, 164 P.3d at 51 (citing *Cohen v. Mirage Resorts, Inc.*, 62 P.3d 720, 729 (Nev. 2003)). Thus, even if the exclusivity provision applied, it would not bar a breach of fiduciary duty claim. *Id.* As the *McMinn* court stated:

> To hold otherwise would erase significant developments in New Mexico law on closely held corporations that took place in spite of the existence of the appraisal remedy and the exclusivity provision in Section 53-15-3. . . . [C]ontrolling shareholders in close corporations potentially could engage in oppressive tactics in breach of their fiduciary duties, and then escape liability for those actions simply by instituting an appraisal-triggering transaction to relegate minority shareholders to an appraisal proceeding for their shares.

McMinn, 164 P.3d at 51.

Describing a scenario that is especially relevant to the case at hand, the *McMinn* court was most troubled by the possibility that the exclusivity provision in an appraisal remedy would be used to eradicate breach of fiduciary duty claims that existed *before* the majority shareholders implemented a fundamental change such as a freeze out merger:

> Perhaps even more troubling than the prospect that exclusivity of appraisal will undermine the strict scrutiny of conflict of interest transactions is the possibility that

> appraisal will be used to extinguish legitimate claims based on director misconduct that occurred prior to the appraisal-triggering event.

McMinn, 164 P.3d at 51. The scenario feared by *McMinn* has become reality in the instant case.

The *McMinn* court then explained that forcing out a minority shareholder who has challenged misconduct by the majority shareholders or directors could itself be viewed as a breach of fiduciary duty:

> In a case like this, where controlling directors are alerted to allegations of a breach of fiduciary duty prior to considering a plan of merger, the institution of a merger transaction with no other purpose than to eliminate the non-controlling shareholder could be devised to relegate the complaining shareholder to an appraisal remedy in order to extinguish such claims. **In such circumstances, the directors' conduct in designing the merger can itself be seen as a breach of fiduciary duty.** Such conduct should not be permitted to go unscrutinized, and, if proven to breach a fiduciary duty, unredressed.

McMinn, 164 P.3d at 51 (emphasis added). Here, Snyder and Hannah had one purpose for employing the reverse stock splits: to eliminate Pisheyar as a shareholder.

Not wanting to transform the appraisal remedy into a shield to protect the misconduct of majority shareholders, *McMinn* held that the exclusivity provision did not bar a breach of fiduciary duty claim:

> Nothing in the appraisal statute indicates that cashed-out shareholders cannot pursue claims based on conduct antecedent or unrelated to the appraisal-triggering transaction itself. Further, the express exception in the statute for unlawful actions encompasses claims based on director misconduct that breaches a fiduciary duty. As we

> have said, if appraisal were the exclusive remedy for shareholders of closely held corporations whose interests are cashed out in conflict of interest mergers, then the remedy would no longer serve its original purpose: to protect dissenting shareholders. **What was designed as a shield to benefit minority shareholders who had lost their power to veto fundamental corporate transactions, would be transformed into a sword for majority oppression of the minority.** Such a result is contrary to longstanding common law principles of fiduciary duty. [citations omitted] We decline to interpret the appraisal statute in a manner that would undermine those principles and the New Mexico case law that has developed in this area since the last time the statute was amended.

McMinn, 164 P.3d at 53 (emphasis added).

The parallels between *McMinn* and the case at hand are striking. In both cases:

- A minority shareholder was a founding shareholder of a corporation with two majority shareholders;
- The two majority shareholders were also directors of the corporation;
- The minority shareholder alleged that the two majority shareholders/directors breached their fiduciary duty and engaged in oppressive conduct;
- The two majority shareholders forcibly stripped the minority shareholder of his interest in the corporation after the minority shareholder questioned the conduct of the majority shareholders;

- The transaction that stripped the minority shareholder of his interest in the corporation was a conflict of interest transaction because the majority shareholders/directors stood on both sides of the transaction and benefited from its execution;
- The majority shareholders argued that the statutory appraisal remedy was the exclusive means for challenging the transaction;
- Common law claims, such as beach of fiduciary duty and shareholder oppression, protected the minority shareholder;
- A lower court ruled that the appraisal remedy was the exclusive means for challenging a transaction that stripped the minority shareholder of his interest in the corporation.

Like the New Mexico Supreme Court, this Court should reverse the lower court and hold that the appraisal remedy in RCW 23B.13.020 is not the exclusive means for redressing the misconduct of the majority shareholders that occurred before, during and after the implementation of a reverse stock split. Thus, Pisheyar's common law claims for breach of fiduciary duty and minority shareholder oppression for the Defendants' conduct before, during and after the reverse stock splits should be unaffected by the appraisal remedy in RCW 23B.13.020. Furthermore, the reverse stock splits themselves constitute minority oppression, breaches of fiduciary duty and a breach of contract.

4. Decisions from Delaware and Several Other Jurisdictions Hold that Common Law Claims May Coexist with the Statutory Appraisal Remedy.

While acknowledging a lack of uniformity among jurisdictions, the *McMinn* court cited the many decisions from other jurisdictions allowing breach of fiduciary duty claims to go forward despite the presence of an appraisal remedy. *McMinn*, 164 P.3d at 53. For example, *McMinn* cited *Mullen v. Academy Life Ins. Co.*, 705 F.2d 971, 973 (8th Cir. 1983) for noting the developing body of case law holding that majority shareholders have fiduciary duties to minority shareholders independent of the statutory appraisal remedy. *McMinn*, 164 P.3d at 53.

In *Mullen,* the Eighth Circuit relied upon this trend to predict that New Jersey would allow breach of fiduciary claims to coexist with the appraisal remedy:

> Accordingly, we conclude that New Jersey would be more likely to follow the lead of courts which have held appraisal not to be exclusive in fact, even where the applicable statutes apparently specify appraisal as the exclusive remedy for dissenters.

Mullen, 705 F.2d at 974.

The *McMinn* court also cited a North Carolina court's holding that statutory appraisal is not the exclusive remedy when the minority shareholder has presented common law claims that did not challenge the appraisal price alone. *McMinn*, 164 P.3d at 53 (citing *IRA for Benefit of Oppenheimer v. Brenner Cos.*, 419 S.E.2d 354, 357 (N.C. App. 1992) ("[A] statutory appraisal is not a dissenting shareholder's exclusive remedy

when the shareholder has presented claims of breach of fiduciary duty, fraud, self-dealing, securities violations, or similar claims based on allegations other than solely the inadequacy of the stock price.")).

McMinn, however, was most persuaded by the approach taken by Delaware courts. *McMinn*, 164 P.3d at 53. Acknowledging Delaware's expertise in matters of corporate law, *McMinn* classified *Weinberger, supra,* as "the seminal Delaware case on exclusivity of appraisal" and recognized that the Delaware case held that "the appraisal remedy may not be adequate for cases involving director misconduct." *McMinn*, 164 P.3d at 53-4. Indeed, *Weinberger* is cited with approval in the Official Legislative History to RCW 23B.13.020. Official Legislative History, App. B at 13.020-4.

In addition to the above cases, several other courts have held that the appraisal remedy did not preclude common law actions for breach of fiduciary duty or minority oppression. For example, the Hawaii Supreme Court relied upon Delaware law in holding that the appraisal remedy did not bar a claim for breach of fiduciary duty:

> We find Delaware caselaw most persuasive. We agree that a merger effected for the sole purpose of freezing out the minority interest is a violation of fiduciary principles governing the relationship between controlling and minority shareholders. We conclude that appraisal is not the exclusive remedy available to Perl if the above violation is established.

Perl v. IU Intern. Corp., 607 P.2d 1036, 1046 (Haw. 1980); *see also Stepak v. Schey*, 553 N.E.2d 1072, 1074-75 (Ohio 1990) ("[A]n action for

breach of fiduciary duty may be brought outside the appraisal statute."); *Bayberry Associates v. Jones*, 783 S.W.2d 553, 561-62 (Tenn. 1990) (despite appraisal statute, courts retain equitable right to assure fairness, including fair price and fair dealing); *Coggins v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1112, 1117-18 (Mass. 1986) ("Judicial inquiry into a freeze-out merger in technical compliance with the statute may be appropriate, and the dissenting stockholders are not limited to the statutory remedy of judicial appraisal where violations of fiduciary duties are found."); *Lazar v. Robinson Knife Mfg. Co., Inc.*, 262 A.D.2d 968, 969 (N.Y.A.D. 1999) ("[If] plaintiffs establish that a breach of fiduciary duty occurred, then the actions of defendants are unlawful and plaintiffs may be entitled to equitable relief . . . [and] action is not barred by the exclusivity provision in Business Corporation Law § 623(k)").

Also, the Washington Corporate Law Handbook notes a court's historical equitable power to remedy majority misconduct independent of the appraisal remedy:

> Numerous cases have held that the court's historic equitable power to protect minority shareholders from the fraud and self-dealing of the majority has not been lessened by legislative enactment of appraisal statutes. These cases have recognized equitable remedies other than appraisal.

McGaughey, § 8.04 at 163 (citations omitted).

This Court should follow the Supreme Courts of Delaware, New Mexico, Hawaii and the other courts listed above and hold that the appraisal remedy in RCW 23B.13.020 does not preclude common law

claims for breach of fiduciary duty and shareholder oppression where a minority shareholder has alleged misconduct by majority shareholders in a closely held corporation.

5. The Term "Fraudulent" as Used in RCW 23B.13.020 Incorporates a Claim for Breach of Fiduciary Duty.

As *McMinn* noted, the term "fraudulent" incorporates a claim for breach of fiduciary duty. In support of this position, *McMinn* cited the Nevada Supreme Court decision in *Cohen.* The *Cohen* court, in holding that the appraisal statue did not bar claims for wrongdoing associated with the transaction that triggered the appraisal process, noted that the term "fraudulent" encompasses claims for breach of fiduciary duty:

> [T]he term "fraudulent," as used in the Model Act, has not been limited to the elements of common-law fraud; it encompasses a variety of acts involving breach of fiduciary duties imposed upon corporate officers, directors, or majority shareholders. We conclude that the term "fraudulent" as used in NRS 92A.380(2) has a similar scope.

Cohen., 62 P.3d at 728-29 (footnotes omitted).

The *Cohen* court cited two cases for the proposition that the term "fraudulent" in the Model Act encompasses claims for a breach of fiduciary duty: *Sifferle v. Micom Corp.,* 384 N.W.2d 503, 507 (Minn. Ct. App. 1986) and *Stringer v. Car Data Systems, Inc.*, 841 P.2d 1183, 1192-93 (Or. 1992). Both *Sifferle* and *Stringer* cited the nearly identical comments to the model acts that formed the basis for their state's appraisal remedy. These comments state that if a corporation attempts an act "in

violation of a fiduciary duty" then a court's freedom to intervene is unaffected by the presence of the appraisal remedy. *Sifferle*, 384 N.W.2d at 507; *Stringer*, 841 P.2d at 1192-93. By approving the comments that incorporate breach of fiduciary duty claims, "the Minnesota legislature intended the term 'fraudulent' . . . to be construed more broadly than strict common-law fraud." *Sifferle*, 384 N.W.2d at 507.

The Official Legislative History to RCW 23B.13.020 also states that "If the corporation attempts an action . . . in violation of a fiduciary duty," then "the court's freedom to intervene should be unaffected by the presence or absence of dissenters' rights." Official Legislative History, App. B. at 13.020-2. As in *Sifferle*, *Stringer*, *Cohen*, and *McMinn*, the legislative history indicates that the Washington Legislature intended the term fraudulent to include a claim for breach of fiduciary duty.

6. Leading Authorities on Corporate Law and Minority Oppression Acknowledge Court Authority To Remedy Shareholder Misconduct Apart from the Dissenter's Rights in Appraisal Statutes.

A leading treatise on the law of corporations notes that many jurisdictions recognize a court's inherent authority to remedy wrongful conduct regardless of the presence of statutory appraisal rights:

> In some states, whether by express statute or by judicial construction, an appraisal right is made the exclusive remedy, yet in many of those states, as well as in other jurisdictions, equitable relief for fraudulent or illegal transactions is not foreclosed. Where the shareholder alleges fraud, unfair dealing or breaches of fiduciary obligations, the shareholder should not be deprived of the remedies of rescission and injunctive relief that might be

> necessary to restore the shareholder to the position he or she otherwise would have occupied. Further, in some jurisdictions, the courts have decided that appraisal is not an exclusive remedy even though the applicable statutes apparently state it as exclusive.

15 W.M. Fletcher, *Fletcher Cyclopedia of the Law of Corporations,* § 7165 (2007) (footnotes omitted).

In addition, the leading treatise on oppression of minority shareholders, *O'Neal and Thompson's Oppression of Minority Shareholders and LLC Members*, supports the position that a court has independent authority to remedy oppressive conduct that is unaffected by the presence of dissenters' rights in RCW 23B.13.020. As this treatise states:

> Fiduciary duty often acts as an important restraint on action by controlling shareholders that seems clearly permitted by the language of the applicable statute. The Delaware Supreme Court has said on more than one occasion "inequitable action does not become permissible simply because it is legally possible."

2 F. H. O'Neal and R. B. Thompson, *Oppression of Minority Shareholders and LLC Members* § 7:3 (2006) (footnotes omitted)

As a result, the treatise noted that:

> Courts sometimes use fiduciary duty to prevent inequitable conduct by a controlling shareholder which seems permissible under the bare words of a corporate statute.

Id.

The Official Legislative History, *McMinn, Weinberger*, leading authorities on corporate law, and the cases cited above all support the

proposition that the remedy provided by RCW 23B.13.020 is not exclusive and does not limit a court's authority to address oppressive conduct or breaches of fiduciary duty by majority shareholders and directors. This conclusion is especially compelling where, as here, a minority shareholder in a closely held corporation has alleged misconduct by the majority shareholders *before* the majority implemented a reverse stock split.

As Commissioner Craighead noted in her ruling granting review, a holding that Pisheyar's claims for breach of fiduciary duty and minority oppression may go forward independent of the appraisal rights in RCW 23B.13.020, would affect the trial court's ruling that he lacked standing to pursue these claims as derivative actions. However, even if this Court rules that the appraisal remedy is exclusive, the following section illustrates Pisheyar has standing to maintain his shareholder derivative claim for breach of fiduciary duty.

D. Pisheyar Has Standing To Assert Derivative Claims Where He Was a Shareholder When He Filed Suit and He Did Not Acquiesce in the Termination of His Shareholder Status.

In its December 29, 2006 order, the trial court held that as a matter of law, Pisheyar lacked standing to assert derivative claims. (CP 509) Because Pisheyar was no longer a shareholder after implementation of the reverse stock split, the trial court concluded that he lacked standing.

Regarding shareholder status to bring a derivative suit, Civil Rule 23.1 states only that "the plaintiff was a shareholder or member *at the time of the transaction of which he complains* or that his share or membership

thereafter devolved on him by operation of law. . . ." CR 23.1 (emphasis added). See also RCW 23B.07.400, which states:

> (1) A person may not commence a proceeding in the right of a domestic or foreign corporation unless the person was a shareholder of the corporation *when the transaction complained of occurred* or unless the person became a shareholder through transfer by operation of law from one who was a shareholder at that time.

RCW 23B.07.400 (emphasis added).

No Washington case has addressed the issue of whether a litigant in a shareholder derivative suit must maintain shareholder status throughout the case. Although the general rule is that a shareholder must maintain shareholder status throughout the litigation, there are several exceptions to this rule. 13 W.M. Fletcher, *Fletcher Cyclopedia of the Law of Corporations*, § 5972 (2007).

One such exception has been adopted by the American Law Institute. *See* Standing to Commence and Maintain A Derivative Action, *Principles of Corporate Governance* § 7.02 (ALI 1994) (the "*Principles*"). According to these *Principles*, a shareholder has standing to maintain a derivative action if the holder:

> Continues to hold the equity security until the time of judgment, **unless the failure to do so is the result of corporate action in which the holder did not acquiesce**, and either (A) the derivative action was commenced prior to the corporate action terminating the holder's status, or (B) the court finds that the holder is better able to represent the interests of the shareholders than any other holder who has brought suit;

Principles, § 7.02(a)(2).

The Oregon Court of Appeals adopted the final draft version of § 7.02 in *Noakes v. Schoenborn,* 841 P.2d 682 (Or. Ct. App. 1992). In *Noakes*, the trial court dismissed plaintiffs' derivative claims because the plaintiffs were no longer shareholders. *Id.* at 684-85. On appeal, *Noakes* began by noting the exception to the general rule that shareholders must maintain their shareholder status throughout the litigation:

> In *Metal Tech Corp. v. Metal Teckniques Co.,* 74 Or. App. 297, 302, 703 P.2d 237 (1985), we said:
>
> > ". . . A person must continue to be a shareholder throughout the litigation to have an incentive to prosecute an action fully and fairly."
>
> That is the general rule. *See, e.g., Lewis v. Chiles,* 719 F.2d 1044, 1047 (9th Cir.1983). **However, limited exceptions to the general rule arise when a shareholder is involuntarily deprived of stock ownership.** The principal exceptions have been tentatively codified by the American Law Institute in *Principles of Corporate Governance* (Proposed Final Draft, March 31, 1992) (the *Principles*).

Noakes, 841 P.2d at 685 (emphasis added).

The *Noakes* court proceeded to adopt the rule espoused in §7.02(a)(2) of the *Principles of Corporate Governance:*

> [W]e find the *Principles* helpful in considering the question and agree with the basic rule expressed in section 7.02(a)(2) and its comment. Applying the rule to the facts alleged in this case, we find that a fair inference to be drawn from plaintiffs' allegations is that they were involuntarily eliminated as shareholders by the majority's decision to liquidate and dissolve FTW. Thus, **their failure to hold a continuing interest was the result of corporate**

> **action in which they did not acquiesce**. Furthermore, plaintiffs are better able to represent the interests of the corporation, primarily because the other shareholders were involved with, or acquiesced in, the wrongdoing.

Noakes, 841 P.2d at 686 (emphasis added) (footnote omitted). For these reasons, the *Noakes* court held that plaintiffs had standing to maintain a derivative action. *Id.* ("We hold that, under the facts alleged in this case, plaintiffs have standing to bring a derivative action.")

Like the plaintiffs in *Noakes*, Pisheyar owned stock in the Corporations when he filed suit and he lost his shareholder status pursuant to a corporate action he opposed. Like the plaintiffs in *Noakes*, Pisheyar is better suited to maintain a derivative action because the other shareholders are involved in the wrongdoing that harmed the Corporations.

This Court should follow *Noakes* and adopt the rule for standing as stated in § 7.02 of the *Principles*. Under this rule, a shareholder who owned stock when he or she commenced litigation must continue to hold the stock, unless the failure to do so is the result of corporate action in which the holder did not acquiesce. Under this rule, Pisheyar has standing to pursue the derivative claims.

E. The Trial Court Erred by Classifying as "Derivative" Pisheyar's Individual Claims That Stemmed from His Shareholder Status.

The final issue certified for appeal is the scope of damages that are properly defined as "derivative" and recoverable solely in a shareholder derivative action. The trial court characterized all damages that derived from Pisheyar's status as a shareholder as "derivative," and dismissed

them as a matter of law. By doing so, the trial court severely restricted his individual claims. The trial court erred, however, because not all damages that stem from shareholder status are derivative.

A minority shareholder who believes that the majority shareholders' conduct is injuring a corporation may bring an action against the offending parties on behalf of the corporation, if the requirements of Civil Rule 23.1 have been met. If the injury is solely to the individual, and not to the corporation, the shareholder may bring only a direct action against the majority shareholders. 12B W.M. Fletcher, *Fletcher Cyclopedia of the Law of Corporations* § 5911 (2007).

In some cases, these damages may overlap. *Interlake Porsche & Audi, Inc.,* 45 Wn. App. at 508. In *Interlake Porsche & Audi*, for example, a minority shareholder recovered damages on behalf of himself and the shareholders generally, as a result of the breach of fiduciary duty of a director, officer, and controlling shareholder, who used corporate funds and assets for his personal benefit. *Id.*

Here, some of the damages claimed by Pisheyar affect all shareholders (e.g., Defendants' billing the Corporations for their attorneys' fees). Other damages affect only Pisheyar, even though they derive from his status as a former shareholder (e.g., loss of salary as a corporate officer). In this situation, the same wrongful conduct gives rise to both derivative and individual claims, entitling a shareholder to maintain derivative and direct actions simultaneously. *See, e.g. Norman v. Nash Johnson & Sons' Farms, Inc.*, 537 S.E. 2d 248, 259 (N.C. Ct. App.

2000) (minority shareholders could bring individual action against majority shareholders and derivative action on behalf of the corporation).

Thus, even if this Court affirms the trial court's holding that Pisheyar lacked standing to maintain a lawsuit on behalf of the Corporations, the trial court's dismissal of all damages arising out of Pisheyar's former status as a shareholder should be reversed. The trial court's December 2006 ruling, which purported to dismiss only a portion of Pisheyar's claim for oppression of a minority shareholder, effectively eviscerated his individual claims for breach of fiduciary duty, conversion of corporate assets, and breach of shareholder agreement. The trial court's characterization of the scope of permissible damages for Pisheyar's individual claims is not tenable. Pisheyar should be allowed to prove all damages resulting from the majority shareholders' conduct, rather than being limited to damages for the loss of benefits such as the use of "demo" cars and receipt of tickets to sporting events.

VII. CONCLUSION

By rejecting Pisheyar's common law and shareholder derivative claims, the trial court transformed RCW 23B.13.020 from a statute intended to protect minority shareholders into a sword for majority oppression of the minority and a shield to protect the misconduct of the majority. This Court should hold that RCW 23B.13.020 does not foreclose common law claims for minority oppression or breach of fiduciary duty when a minority shareholder in a closely held corporation alleges

misconduct by the majority. By reversing the trial court, this Court would honor the original purpose of RCW 23B.13.020 and recognize a court's independent authority to remedy shareholder misconduct. In addition, this Court should hold that a plaintiff who was a shareholder when the suit began and who did not acquiesce in the decision to eliminate his shareholder status, has standing to maintain shareholder claims throughout the litigation. For these reasons, Pisheyar requests that this Court reverse the trial court's rulings regarding RCW 23B.13.020, standing, and the characterization of Pisheyar's damages, so that Pisheyar may pursue his full range of remedies at trial.

DATED this 13th day of November, 2007.

VANDEBERG JOHNSON & GANDARA, LLP

By _____

Daniel C. Montopoli, WSBA #26217
Lucy R. Clifthorne, WSBA #27287
James A. Krueger, WSBA #3408
Attorneys for Appellant/Cross-Respondent Afshin Pisheyar

APPENDICES

Appendix A: The trial court's Order on Defendants' Motion for Reconsideration or in the Alternative for Certification for Appeal for Appellate Review and Stay of Action, filed December 29, 2006. CP 508-10.

Appendix B: RCW 23GB.13.020 and its Official Legislative History, Senate Journal 51st Legis. 3087-88 (1989), from Washington Business Corporate Act (23B), Washington State Bar Association (2005), pages 13-020-1 to 13.020-4.

Appendix C: *McMinn v. MBF Operating Acquisition Corp.*, 164 P.3d 41 (N.M. 2007).

APPENDIX A

FILED
KING COUNTY, WASHINGTON

DEC 29 2006

SUPERIOR COURT CLERK
BY DONNALEE PICKREL
DEPUTY

ORIGINAL

IN THE SUPERIOR COURT OF WASHINGTON FOR KING COUNTY

AFSHIN PISHEYAR, Plaintiff, v. RICHARD M. SNYDER, et ux., DAVID HANNAH, et ux., and SOUND INFINITI, INC., d/b/a INFINITI OF KIRKLAND, Defendants	NO. 05-2-08240-2 KNT ORDER ON DEFENDANTS' MOTION FOR RECONSIDERATION OR IN THE ALTERNATIVE, FOR CERTIFICATION FOR APPEAL FOR APPELLATE REVIEW AND STAY OF ACTION

THIS MATTER having come on for hearing before the undersigned on the defendants' motion for reconsideration of the court's order denying defendants' motions for summary judgment on plaintiff's minority shareholder oppression and damages claims, and on defendants' motion in the alternative for certification for appeal for appellate review and stay of action, and the court having considered the following:

1. Defendants' Motion Reconsideration or in the alternative, for Certification for Appeal for Appellate Review and Stay of Action, and
2. Plaintiff's Response and request for sanctions,

and the court being fully advised, now therefore, it is hereby

ORDERED that Defendants' motion is granted in part, and this court's Orders dated December 5, 2006 are hereby clarified and modified as follows:

A. The following claims for "minority shareholder oppression" are dismissed:

1) Plaintiff's claim for damages arising from Defendants' implementation of the reverse stock split that resulted in Plaintiff's holding a fractional share. The court finds that the remedy available to Plaintiff under RCW 23B.13.020(1)(d) is exclusive, as there is no evidence before the court that the transaction either failed to comply with procedural requirements, or was fraudulent. *See Matthews v. Wenatchee Heights Water Co.*, 92 Wn. App. 541, 555 (1998), and Official Legislative History of RCW 23B.13.020: "The [dissenter's rights] remedy is the exclusive remedy unless the transaction fails to comply with procedural requirements or is 'fraudulent.'"

2) Plaintiff's claim for damages arising out of his claims that defendants' conduct resulted in reduced corporate profits, or increased corporate expenses, and therefore in reduced dividend distributions. The court finds that such claims are derivative in nature, and that plaintiff lacks standing to assert them.

3) Plaintiff's claim for damages arising out of his wrongful termination claim, which was dismissed earlier on summary judgment.

B. Plaintiff may assert claims for damages arising out of alleged "minority shareholder oppression" for alleged deprivation of shareholder "perquisites", such as demo cars, sports tickets, and the like, subject to this court's previous ruling that plaintiff will be

limited at trial to presentation of evidence that was disclosed to defendants in pre-trial discovery.

C. Defendants' request for certification for appeal and stay of action is denied.

DATED this 28th day of December, 2006.

JUDGE ANDREA DARVAS

APPENDIX B

RCW 23B.13.020
RIGHT TO DISSENT

CURRENT SECTION

1) A shareholder is entitled to dissent from, and obtain payment of the fair value of the shareholder's shares in the event of, any of the following corporate actions:

(a) Consummation of a plan of merger to which the corporation is a party (i) if shareholder approval is required for the merger by RCW 23B.11.030, 23B.11.080, or the articles of incorporation, and the shareholder is entitled to vote on the merger, or (ii) if the corporation is a subsidiary that is merged with its parent under RCW 23B.11.040;

(b) Consummation of a plan of share exchange to which the corporation is a party as the corporation whose shares will be acquired, if the shareholder is entitled to vote on the plan;

(c) Consummation of a sale or exchange of all, or substantially all, of the property of the corporation other than in the usual and regular course of business, if the shareholder is entitled to vote on the sale or exchange, including a sale in dissolution, but not including a sale pursuant to court order or a sale for cash pursuant to a plan by which all or substantially all of the net proceeds of the sale will be distributed to the shareholders within one year after the date of sale;

(d) An amendment of the articles of incorporation, whether or not the shareholder was entitled to vote on the amendment, if the amendment effects a redemption or cancellation of all of the shareholder's shares in exchange for cash or other consideration other than shares of the corporation; or

(e) Any corporate action taken pursuant to a shareholder vote to the extent the articles of incorporation, bylaws, or a resolution of the board of directors provides that voting or nonvoting shareholders are entitled to dissent and obtain payment for their shares.

(2) A shareholder entitled to dissent and obtain payment for the shareholder's shares under this chapter may not challenge the corporate action creating the shareholder's entitlement unless the action fails to comply with the procedural requirements imposed by this title, RCW 25.10.900 through 25.10.955, the articles of incorporation, or the bylaws, or is fraudulent with respect to the shareholder or the corporation.

(3) The right of a dissenting shareholder to obtain payment of the fair value of the shareholder's shares shall terminate upon the occurrence of any one of the following events:

(a) The proposed corporate action is abandoned or rescinded;

(b) A court having jurisdiction permanently enjoins or sets aside the corporate action; or

(c) The shareholder's demand for payment is withdrawn with the written consent of the corporation.

HISTORY AND COMMITTEE COMMENTARY

ORIGINAL SECTION Laws 1989, ch. 165, §141 (eff. 7-1-90)

1) A shareholder is entitled to dissent from, and obtain payment of the fair value of the shareholder's shares in the event of, any of the following corporate actions:

(a) Consummation of a plan of merger to which the corporation is a party (i) if shareholder approval is required for the merger by RCW 23B.11.030 or the articles of incorporation, and the shareholder is entitled to vote on the merger, or (ii) if the corporation is a subsidiary that is merged with its parent under RCW 23B.11.040;

(b) Consummation of a plan of share exchange to which the corporation is a party as the corporation whose shares will be acquired, if the shareholder is entitled to vote on the plan;

(c) Consummation of a sale or exchange of all, or substantially all, of the property of the corporation other than in the usual and regular course of business, if the shareholder is entitled to vote on the sale or exchange, including a sale in dissolution, but not including a sale pursuant to court order or a sale for cash pursuant to a plan by which all or substantially all of the net proceeds of the sale will be distributed to the shareholders within one year after the date of sale;

(d) An amendment of the articles of incorporation that materially reduces the number of shares owned by the shareholder to a fraction of a share if the fractional share so created is to be acquired for cash under RCW 23B.06.040; or

(e) Any corporate action taken pursuant to a shareholder vote to the extent the articles of incorporation, bylaws, or a resolution of the board of directors provides that voting or nonvoting shareholders are entitled to dissent and obtain payment for their shares.

(2) A shareholder entitled to dissent and obtain payment for the shareholder's shares under this chapter may not challenge the corporate action creating the shareholder's entitlement unless the action fails to comply with the procedural requirements imposed by this title, the articles of incorporation, or the bylaws, or is fraudulent with respect to the shareholder or the corporation.

(3) The right of a dissenting shareholder to obtain payment of the fair value of the shareholder's shares shall terminate upon the occurrence of any one of the following events:

(a) The proposed corporate action is abandoned or rescinded;

(b) A court having jurisdiction permanently enjoins or sets aside the corporate action; or

(c) The shareholder's demand for payment is withdrawn with the written consent of the corporation.

OFFICIAL LEGISLATIVE HISTORY Senate Journal 51st Legis. 3087-88 (1989)

Section 13.02 Right to Dissent.

Proposed subsection 13.02(a) establishes the scope of a shareholder's right to dissent (and the shareholder's resulting right to obtain payment for the shareholder's shares) by defining the transactions with respect to which a right to dissent exists. These transactions are:

(1) A plan of merger if the shareholder (i) is entitled to vote on the merger under Proposed section 11.03 or pursuant to provisions in the articles of incorporation, or (ii) is a shareholder of a subsidiary that is merged with a parent under Proposed section 11.04. The right to vote on a merger under Proposed section 11.03 extends to corporations whose separate existence disappears in the merger and to the surviving corporation if the number of its authorized shares is increased as a result of the merger.

(2) A share exchange under Proposed section 11.02 if the corporation is a party whose shares are being acquired by the plan and the shareholder is entitled to vote on the exchange.

(3) A sale or exchange of all or substantially all of the property of the corporation not in the usual course of business under Proposed section 12.02 if the shareholder is entitled to vote on the sale or exchange. Proposed subsection 13.02(a)(3) generally grants dissenters' rights in connection with sales in the process of dissolution but excludes them in connection with sales by court order and sales for cash that require substantially all the net proceeds to be distributed to the shareholders within one year. The inclusion of sales in dissolution is designed to ensure that the right to dissent cannot be avoided by

characterizing sales as made in the process of dissolution long before distribution is made. An exception is provided for sales for cash pursuant to a plan that provides for distribution within one year. These transactions are unlikely to be unfair to minority shareholders since majority and minority are being treated in precisely the same way and all shareholders will ultimately receive cash for their shares. A sale other than for cash gives rise to a right of dissent since property sometimes cannot be converted into cash until long after receipt and a minority shareholder should not be compelled to assume the risk of delays or market declines. Similarly, a plan that provides for a prompt distribution of the property received gives rise to the right of dissent since the minority shareholder should not be compelled to accept for the shareholder's shares different securities or other property that may not be readily marketable.

The exclusion of court-ordered sales from the dissenter's right is based on the view that court review and approval ensures that an independent appraisal of the fairness of the transaction has been made.

(4) The Committee rejected the extension made by RMA §13.02 of dissenters' rights to a significant number of amendments to articles of incorporation. The committee concluded that significant overreaching in such transactions would be limited by equity courts' investigations into the fairness of the exercise of majority power. It did preserve dissenters' rights for reverse stock splits resulting in fractions of shares, where the corporation is to pay cash for the shares. It felt that providing the dissenters' right in such circumstances would afford minority shareholders additional protection from such transactions, while enhancing the majority's freedom to make such changes.

(5) Any corporate action to the extent the articles, bylaws, or a resolution of the board of directors grant a right of dissent. Corporations may wish to grant on a voluntary basis dissenters' rights in connection with important transactions (e.g., those submitted for shareholder approval). The grant may be to nonvoting shareholders in connection with transactions that give rise to dissenters' rights with respect to voting shareholders. The grant of dissenters' rights may add to the attractiveness of preferred shares, and may satisfy shareholders who would, in the absence of dissenters' rights, sue to enjoin the transaction. Also, in situations where the existence of dissenters' rights may otherwise be disputed, the voluntary offer of those rights under this section will avoid a dispute.

Generally, only shareholders who are entitled to vote on the transaction are entitled to assert dissenters' rights with respect to the transaction. The right to vote may be based on the articles of incorporation or other provisions of the Proposed Act. For example, a class of nonvoting shares may nevertheless be entitled to vote (either as a separate voting group or as part of the general voting group) on an amendment to the articles of incorporation that affects them as provided in one of the ways set forth in Proposed section 10.04; such a class is entitled to vote under Proposed section 11.03 and to assert dissenters' rights if the transaction effecting such amendment to the articles also falls within Proposed section 13.02. On the other hand, such a class does not have the right to vote on a sale of substantially all the corporation's assets not in the ordinary course of business, and therefore, that class is not entitled to assert dissenters' rights with respect to that sale. One exception to this principle is the merger of a subsidiary into its parent under Proposed section 11.04 in which minority shareholders of the subsidiary have the right to assert dissenters' rights even though they have no right to vote.

Proposed subsection 13.02(b) basically adopts the New York formula as to exclusivity of the dissenters' remedy of this chapter. The remedy is the exclusive remedy unless the transaction fails to comply with procedural requirements or is "fraudulent." The theory underlying this section is as follows: when a majority of shareholders has approved a corporate change, the corporation should be permitted to proceed even if a minority considers the change unwise or disadvantageous, and persuades a court that this is correct. Since dissenting shareholders can obtain the fair value of their shares, they are protected from pecuniary loss. Thus in general terms an exclusivity principle is justified. But the prospect that shareholders may be "paid off" does not justify the corporation in proceeding without complying with procedural requirements or fraudulently. If the corporation attempts an action in violation of the corporation law on voting, in violation of clauses in articles of incorporation prohibiting it, by deception of shareholders, or in violation of a fiduciary duty--to take some examples--the court's freedom to intervene

should be unaffected by the presence or absence of dissenters' rights under this chapter. Because of the variety of situations in which procedural defects and fraud may appear, this section makes no attempt to specify particular illustrations. Rather, it is designed to recognize and preserve the principles that have developed in the case law of Delaware, New York and other states with regard to the effect of dissenters' rights on other remedies of dissident shareholders. See Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)(appraisal remedy may not be adequate "where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross or palpable overreaching are involved"); Walter J. Schloss Associates v. Arkwin Industries, Inc., 455 N.Y.S.2d 844, 847-52 (App. Div. 1982)(dissenting opinion), reversed, with adoption of dissenting opinion, 460 N.E.2d 1090 (Ct. App. 1984). See also Vorenberg, "Exclusiveness of the Dissenting Stockholders' Appraisal Right," 77 HARV. L. REV. 1189 (1964).

The Committee added Proposed subsection 13.02(c) to retain the substance of the provisions in the old law related to circumstances in which a dissenting shareholder's right to obtain payment terminated.

AMENDMENTS TO ORIGINAL SECTION

Laws 1991, ch. 269, §37 (eff. 7-28-91) *(amends original subsection (1)(a) to add ", RCW 23B.11.080," following "RCW 23B.11.030" and amends subsection (2) to add "RCW 25.10.900 through 25.10.955," following "by this title.")*

CARC COMMENTARY

The current statute (in RCW 23B.13.020(1)(d)) grants dissenters' rights to minority shareholders who have been squeezed out by means of a reverse stock split and subsequent repurchase of their fractional shares. This provision originally represented a Washington variation from the comparable section of the Revised Model Business Corporation Act, but has now been adopted as the model approach in the latest revisions to the RMBCA. Under the proposed changes to RCW 23B.13.020(1)(d), this same basic stance is maintained, but the statutory language is conformed to that of proposed subsection RCW 23B.10.040(1)(i). Thus, any shareholder whose relationship to the corporation is being terminated via an articles amendment will continue to have at least a right to dissent and seek appraisal, even though the squeezed-out minority may not have been afforded separate voting group rights under proposed subsection RCW 23B.10.040(1)(i), or may not have had voting rights at all with respect to the squeeze-out.

* * * * *

Laws 2003, ch. 35, §9 (eff. 7-27-03) *(amends only subsection (1)(d) of the original section to read:)*

(d) An amendment of the articles of incorporation, whether or not the shareholder was entitled to vote on the amendment, if the amendment effects a redemption or cancellation of all of the shareholder's shares in exchange for cash or other consideration other than shares of the corporation; or

CARC COMMENTARY

See CARC Comment to 2003 addition of RCW 23B.11.035.

* * * * *

APPENDIX C

McMinn v. MBF Operating Acquisition Corp.
N.M.,2007.

Supreme Court of New Mexico.
Rory A. McMINN, Plaintiff-Petitioner,
v.
MBF OPERATING ACQUISITION CORPORATION, a New Mexico corporation, Frank L. Sturges, and Mark W. Daniels, Defendants, andMBF Operating, Inc., Defendant-Respondent.
No. 29,725.

June 27, 2007.

Background: Minority shareholder in closely held corporation brought claims for breach of fiduciary duties, oppressive conduct, prima facie tort, unjust enrichment, and punitive damages against corporation, successor corporation, and two shareholders in the two corporations, relating to cash-out merger. The District Court, Chaves County, Don Maddox, D.J., dismissed the claims against other shareholders and successor corporation, and later entered judgment on jury's verdict awarding plaintiff $864,000 in compensatory damages and $20,000 in punitive damages, but the trial court refused to award attorney fees to plaintiff. Cross-appeals were taken. The Court of Appeals, 2006-NMCA-049, 139 N.M. 419, 133 P.3d 875, reversed, ruling that appraisal was exclusive remedy in absence of fraud. Plaintiff appealed.

Holdings: On grant of certiorari, the Supreme Court, en banc, Bosson, J., held that:

(1) statutory appraisal remedy was not exclusive remedy;

(2) even if appraisal statute applied, conduct of majority shareholders fell within exception to exclusivity provision; and

(3) conclusion that acquiring corporation had fiduciary duty to minority shareholder was law of the case.

Reversed and remanded to the Court of Appeals.

West Headnotes

[1] Appeal and Error 30 893(1)

30 Appeal and Error
30XVI Review
30XVI(F) Trial De Novo
30k892 Trial De Novo
30k893 Cases Triable in Appellate Court
30k893(1) k. In General. Most Cited Cases
Issues of statutory interpretation are reviewed de novo.

[2] Statutes 361 181(1)

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k180 Intention of Legislature
361k181 In General
361k181(1) k. In General. Most Cited Cases
The primary goal in interpreting statutes is to ascertain and give effect to legislative intent.

[3] Statutes 361 184

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k180 Intention of Legislature
361k184 k. Policy and Purpose of Act. Most Cited Cases

Statutes 361 188

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k188 k. In General. Most Cited Cases
To determine legislative intent when construing a statute, the Supreme Court looks not only to the language used in the statute, but also to the purpose to be achieved and the wrong to be remedied.

[4] Corporations 101 182.3

101 Corporations
101IX Members and Stockholders
101IX(A) Rights and Liabilities as to

Corporation
101k182 Corporate Property, Funds, and Securities
101k182.3 k. Majority and Minority Stockholders in General. Most Cited Cases
The relationship between shareholders in a close corporation is one of trust and confidence, and majority action must be "intrinsically fair" to minority interests.

[5] Fraud 184 ⚿7

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k5 Elements of Constructive Fraud
184k7 k. Fiduciary or Confidential Relations. Most Cited Cases

Fraud 184 ⚿50

184 Fraud
184II Actions
184II(D) Evidence
184k50 k. Presumptions and Burden of Proof. Most Cited Cases
One acting in a fiduciary capacity for another generally has the burden of proving that a transaction with himself was advantageous for the person for whom he was acting.

[6] Corporations 101 ⚿182.3

101 Corporations
101IX Members and Stockholders
101IX(A) Rights and Liabilities as to Corporation
101k182 Corporate Property, Funds, and Securities
101k182.3 k. Majority and Minority Stockholders in General. Most Cited Cases
Statutory appraisal remedy for minority shareholder dissenting from corporate merger did not apply to "freeze out" merger involving two close corporations both controlled by the same shareholders resulting in elimination of minority shareholder's interest in the resulting corporation to preclude minority shareholder's breach of fiduciary duty claim; the intent of the legislature in enacting the appraisal remedy was to protect dissenting shareholders who lost their common law veto power by providing a buy-out requirement. West's NMSA § 53-15-3.

[7] Corporations 101 ⚿182.4(4)

101 Corporations
101IX Members and Stockholders
101IX(A) Rights and Liabilities as to Corporation
101k182 Corporate Property, Funds, and Securities
101k182.4 Sale or Transfer of Assets
101k182.4(4) k. Rights and Remedies of Dissenting Stockholders in General. Most Cited Cases
In a breach of fiduciary duty case where the directors of the defendant corporations stood on both sides of the transaction, the appraisal remedy for dissenting shareholders may not be adequate in certain cases, particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved.

[8] Corporations 101 ⚿182.4(4)

101 Corporations
101IX Members and Stockholders
101IX(A) Rights and Liabilities as to Corporation
101k182 Corporate Property, Funds, and Securities
101k182.4 Sale or Transfer of Assets
101k182.4(4) k. Rights and Remedies of Dissenting Stockholders in General. Most Cited Cases
Even if the statutory appraisal remedy for corporate mergers applied to dissenting minority shareholder's claims against majority shareholders who controlled both sides of merger of close corporations designed to "freeze out" minority shareholder, majority shareholders' conduct in devising merger was oppressive and breached their fiduciary duty, which fell within exception to exclusivity provision of remedy. West's NMSA § 53-15-3.

[9] Corporations 101 ⚿182.4(5)

101 Corporations
101IX Members and Stockholders
101IX(A) Rights and Liabilities as to Corporation
101k182 Corporate Property, Funds, and Securities
101k182.4 Sale or Transfer of Assets
101k182.4(5) k. Payment of Value of Stock. Most Cited Cases
The proper remedy in a breach of fiduciary duty action involving the squeeze-out of a non-controlling

shareholder in a close corporation is compensatory damages measured by the fair value of the former shareholder's shares.

[10] Appeal and Error 30 853

30 Appeal and Error
30XVI Review
30XVI(A) Scope, Standards, and Extent, in General
30k851 Theory and Grounds of Decision of Lower Court
30k853 k. Rulings as Law of Case. Most Cited Cases
Conclusion that fiduciary duty of close corporation that merged with close corporation in which shareholder held minority interest was one and the same with the fiduciary duty of majority shareholders that stood on both sides of the merger was law of the case in minority shareholder's action alleging breach of that duty, and thus, dismissal of claims against individual majority shareholders did not render claim improper, where acquiring corporation admitted that there was fiduciary duty running both ways between the parties, and jury was instructed as to corporation's fiduciary duty without objection.

*42 Sanders, Bruin, Coll & Worley, P.A., Clay H. Paulos, Ian D. McKelvy, Roswell, NM, for Petitioner.
Tucker Law Firm, P.C., Steven L. Tucker, Santa Fe, NM, for Respondent.

BOSSON, Justice.
{1} Plaintiff Rory A. McMinn ("McMinn") was a non-controlling shareholder in a closely-held corporation whose interest in the corporation was eliminated by the controlling shareholders through the use of a "freeze out" merger transaction. That transaction involved two steps. First, the controlling shareholders formed a "shell" corporation, an entity set up for the sole purpose of merging with the existing corporation, of which they were the sole directors. Second, the controlling shareholders caused the shell corporation to merge with the existing corporation, with one condition being the "freeze out" of McMinn, the non-controlling shareholder, by the forced cancellation of his shares through a cash purchase. This appeal involves the application of New Mexico's statutes governing fundamental corporate transactions to this merger.

The New Mexico Dissent and Appraisal Statutes

{2} Adopted in 1983, NMSA 1978, § 53-15-3 (1983) gives shareholders who dissent from mergers the right to obtain payment for the fair value of their shares. If the corporation and the dissenting shareholders cannot agree on that value, the statute allows either party to seek a judicial determination of fair value in a court proceeding called an "appraisal." *See Smith v. First Alamogordo Bancorp, Inc.,* 114 N.M. 340, 343, 838 P.2d *43 494, 497 (Ct.App.1992). The statute does not define "fair value" or the method by which such value is to be calculated. With regard to the appraisal proceeding itself, NMSA 1978, § 53-15-4(E) (1983) simply states that "[a]ll shareholders who are parties to the proceeding shall be entitled to judgment against the corporation for the amount of the fair value of their shares," and the court may appoint one or more appraisers "to receive evidence and recommend a decision on the question of fair value."

{3} The effect of the relevant statutes on the rights of non-controlling shareholders, such as McMinn, who object to a merger is twofold: (1) they eliminate the common law requirement that a merger be unanimously approved and instead require the support of only a majority of shareholders; and (2) in exchange for the dissenting shareholders' loss of their right to veto the transaction, the statutes provide a means for dissenting shareholders to be paid the fair value of their shares. NMSA 1978, § 53-14-3(B) (1983) (providing that majority can approve merger); § 53-15-3 (describing right of dissenting shareholders to obtain payment for their shares).

{4} At issue in this case is the exclusivity provision in Section 53-15-3(D), which states as follows:
A shareholder of a corporation who has a right under this section to obtain payment for his shares shall have no right at law or in equity to attack the validity of the corporate action that gives rise to his right to obtain payment, nor to have the action set aside or rescinded, except when the corporate action is unlawful or fraudulent with regard to the complaining shareholder or to the corporation.

We must determine, as a matter of first impression, whether this exclusivity provision applies to the merger transaction carried out by MBF's controlling shareholders, designed to eliminate the interest of the company's non-controlling shareholder. In making this determination, we inquire into whether the legislature intended the statutory remedy-the

determination of fair cash value in an appraisal proceeding-to be the only remedy for non-controlling shareholders in McMinn's position, to the exclusion of other common law claims such as breach of fiduciary duty. We hold that the legislature did not intend an appraisal to be the exclusive remedy under the circumstances of this case. The Court of Appeals having held otherwise, we reverse and affirm the jury verdict below.

BACKGROUND

{5} In 1992, McMinn, Frank L. Sturges ("Sturges"), and Mark W. Daniels ("Daniels") formed MBF Operating Inc. ("MBF"), a New Mexico corporation engaged in the business of pipeline inspection services. The shares of MBF were divided equally between the three shareholders and it was agreed that all three would share in the profits of the company.

{6} In 2001, McMinn was appointed to the state Public Regulation Commission ("PRC") and resigned his employment with MBF due to the potential conflict of interest created by the fact that MBF is regulated by the PRC. However, McMinn retained his shares in MBF, placing the shares in a blind trust ("Trust"), effective April 30, 2001. The three original shareholders had no written shareholders' agreement or buy-out agreement specifying how to deal with a shareholder who ceased to be employed by the company.

{7} After McMinn's resignation, the trustee of his shares ("Trustee") requested that MBF institute a dividend policy so that McMinn could share in the profits now that he was only a passive shareholder, but no such policy was adopted. During the time that McMinn remained a passive shareholder, the Trustee complained that MBF was engaged in oppressive conduct toward McMinn and that Sturges and Daniels were engaged in self-dealing, including payment of excessive salaries to themselves. The Trustee requested that Sturges and Daniels buy out McMinn's interest in MBF and suggested that, if they did not want to make a fair offer for the stock, liquidation of the company might be an alternative. MBF offered to buy out the Trust, but never made an offer more than the liquidation value of the company. The Trust indicated that it may be necessary to force an involuntary dissolution if the oppressive conduct continued and if all *44 MBF offered was liquidation value for McMinn's shares.

{8} In January of 2002, MBF retained Harold Wells ("Wells") to value MBF for the purpose of a merger that would eliminate McMinn's interest in the company. Wells' valuation would provide the basis for the cash amount MBF would pay McMinn for his shares. Wells was not a certified appraiser, had little financial experience, and no accounting background or experience. On March 4, 2002, Wells prepared a report valuing MBF at $300,000. Based on Wells' report, Daniels and Sturges valued MBF and approved a plan of merger designed to force McMinn out of the company. At this time, the Trust was unaware of Wells or the plan of merger being orchestrated.

{9} On March 25, 2002, in lieu of a special meeting, MBF, through Daniels and Sturges, agreed to the "necessity of separating the Corporation and its business affairs" from McMinn and approved the plan of merger. The Trust first learned of the plan of merger four days later. Under the plan, Sturges and Daniels filed Articles of Incorporation on April 17, 2002, forming MBF Acquisition Corp.; Sturges and Daniels were the sole directors and shareholders of the new corporation. Two days later, on April 19, 2002, the new corporation was merged out of existence.

{10} A meeting was held on April 18, 2002, in the office of MBF's counsel in Albuquerque, one week after the Trust received a copy of Wells' evaluation. Sturges and Daniels approved the plan of merger over the objections of the Trustee. Under the plan, McMinn was to receive approximately $134,000 for his entire 1/3 equal share of MBF. The Trustee objected that the plan of merger was unlawful and the valuation deliberately undervalued; the Trust memorialized these objections in a letter to counsel for MBF the following day. The Trust also demanded issuance of shares in the surviving company, but was refused. On April 30, 2002, MBF wrote a letter to McMinn advising that the merger had been approved, that McMinn had made no written demand for payment of fair value, and that McMinn was therefore bound by the terms of the merger. MBF enclosed with this letter a certified check for $134,411.38 for payment of McMinn's shares in accordance with the merger. McMinn rejected the check.

{11} The Trust filed suit against MBF, Sturges, and Daniels, in September of 2002 for breach of fiduciary duty, oppressive conduct, and prima facie tort. McMinn's term on the PRC ended in January of 2003, and he was substituted in as Plaintiff in the case. McMinn's claims were based on conduct that

occurred before, during, and after the merger, for which McMinn sought compensatory damages, including lost equity and lost profits of the company, and punitive damages. MBF moved for summary judgment, arguing that Section 53-15-3 provided McMinn's exclusive remedy as a dissenting shareholder, but the judge denied the motion and proceeded to trial.

{12} At trial, McMinn argued that Daniels and Sturges had paid themselves excessive salaries and devalued the company in breach of their fiduciary duties to McMinn and then, through the use of the merger, tried to force McMinn out at an unfairly low price based on his wrongfully devalued shares. MBF countered that it had instituted the merger simply to resolve a stalemate between the parties as to the price MBF would pay McMinn to buy him out. McMinn responded to the contrary that the merger was designed to deprive him of his fair share of the profits of the company in contravention of the shareholders' agreement. MBF was permitted to instruct the jury on the business judgment rule [FN1] and argue that its actions were lawful ***45** and based on a valid business purpose. The jury found that MBF had breached its fiduciary duty to McMinn and awarded McMinn $864,000 in compensatory damages as well as $20,000 in punitive damages against MBF.

> FN1. The business judgment rule provides as follows:
> If in the course of management, directors arrive at a decision, within the corporation's powers (inter vires) and their authority, for which there is a reasonable basis, and they act in good faith, as the result of their independent discretion and judgment, and uninfluenced by any consideration other than what they honestly believe to be the best interests of the corporation, a court will not interfere with internal management and substitute its judgment for that of the directors to enjoin or set aside the transaction or to surcharge the directors for any resulting loss.
> *White on Behalf of Banes Co. Derivative Action v. Banes Co.,* 116 N.M. 611, 615, 866 P.2d 339, 343 (1993) (quoted authority omitted).

{13} MBF appealed and the Court of Appeals reversed the judgment in favor of MBF, ruling that statutory appraisal was McMinn's exclusive remedy. *McMinn v. MBF Operating, Inc.,* 2006-NMCA-049, 139 N.M. 419, 133 P.3d 875. In reaching this conclusion, the Court of Appeals first found that the appraisal statute created a new right and remedy not available at common law, and therefore "there is a presumption that the remedy is exclusive." *Id.* ¶ 19. The Court found that there was no evidence of contrary legislative intent that would rebut this presumption and, thus, the legislature intended the appraisal remedy to be exclusive. *Id.* The Court then went on to review decisions of other jurisdictions, concluding that they were in line with its holding. *Id.* ¶ 20. Finally, the Court examined whether McMinn's claims fell within the statutory exception for fraud or unlawful conduct and found that they did not. *Id.*¶ ¶ 29-33. Thus, the Court held that "[b]ecause [McMinn] failed to take advantage of his statutory right to appraisal, he took the risk of being held to the amount offered in the merger and is now bound by the terms of the corporate action." *Id.* ¶ 36. We disagree with the Court of Appeals' interpretation of the appraisal statute and its analysis of the transaction in this case.

STANDARD OF REVIEW

[1][2][3] {14} We must determine whether Section 53-15-3 provides the exclusive remedy for a non-controlling shareholder in a close corporation who dissents from a merger designed to eliminate his interest in the company. This is an issue of statutory interpretation we review de novo. *See State v. Smith,* 2004-NMSC-032, ¶ 8, 136 N.M. 372, 98 P.3d 1022. Our primary goal in interpreting statutes is to ascertain and give effect to legislative intent. *See Cummings v. X-Ray Assocs. of N.M., P.C.,* 1996-NMSC-035, ¶ 44, 121 N.M. 821, 918 P.2d 1321. "To determine legislative intent, we look not only to the language used in the statute, but also to the purpose to be achieved and the wrong to be remedied." *Hovet v. Allstate Ins. Co.,* 2004-NMSC-010, ¶ 10, 135 N.M. 397, 89 P.3d 69.

EXCLUSIVITY OF APPRAISAL

There is No Presumption of Exclusivity

{15} The Court of Appeals' opinion turned on a presumption of exclusivity arrived at by determining that the dissent and appraisal statutes created a new right and remedy not available at common law. Based partially on this presumption, the Court of

Appeals determined that the legislature intended the appraisal remedy to be exclusive, barring any claims for breach of fiduciary duty by a dissenting shareholder that arise out of a freeze out merger transaction.

{16} We think this approach to interpreting the statute is too confined in its focus solely on the text, without a view toward the underlying goals, purposes, and policy of the statutory remedy. Strict application of such a presumption overlooks the purpose of the appraisal statute, which, as we discuss in depth later in this Opinion, was designed to protect dissenting shareholders from oppression by the majority; not make them even more vulnerable to the majority. Appraisal must be viewed in its historical context and addressed not simply as a new right and remedy unavailable at common law, but rather as a right granted in exchange for the loss of a right at common law-the right of a dissenting shareholder to veto and block a merger.

{17} Further, we view our appraisal statute within the context of common law fiduciary duties that exist outside of New Mexico's corporations statutes, and which are essential to maintaining the integrity of business relationships in New Mexico. *See Walta v. Gallegos Law Firm, P.C.,* 2002-NMCA-015, 131 N.M. 544, 40 P.3d 449. Thus, any construction of our statutes that would eliminate such common law claims in the context of fundamental business transactions must be ***46** approached with caution. *See Sims v. Sims,* 1996-NMSC-078, ¶ 22, 122 N.M. 618, 930 P.2d 153 (noting that statutes are to "be read strictly so that no innovation upon the common law that is not clearly expressed by the legislature will be presumed").

Fiduciary Duties of Directors and Shareholders in Close Corporations

{18} To aid our evaluation of the exclusivity provision, we first turn our attention to the nature of the fiduciary duties owed by shareholders to one another in a closely held corporation. The jury found that MBF breached its fiduciary duty to McMinn, a verdict which MBF does not claim was unsupported by substantial evidence. Instead, MBF argues and the Court of Appeals agreed that the availability of the appraisal remedy operates to cut off common law claims for breach of fiduciary duty and limit McMinn to recovery of the fair value of his shares at the time of the merger. We therefore begin by looking at what claims are foreclosed by the Court of Appeals' construction of the appraisal statute to assist us in determining whether appraisal was intended to be an all-encompassing remedy to the exclusion of such claims.

{19} New Mexico has recognized an enforceable fiduciary duty between shareholders of a close corporation outside of the corporation statute's provision for relief from illegal, oppressive, or fraudulent conduct. *Walta,* 2002-NMCA-015, ¶ 30, 131 N.M. 544, 40 P.3d 449. As the Court of Appeals observed in *Walta,*

> [the] characteristics of close corporations may sometimes be abused to allow majority shareholders to take advantage of minority shareholders. Minority shareholders are vulnerable to a variety of oppressive devices. These devices include refusing to declare dividends, draining of corporate earnings in the form of exorbitant salaries and bonuses paid to majority shareholders, denying minority shareholders corporate offices and employment, and selling corporate assets to majority shareholders at reduced prices.

Id. ¶ 33. Some of these same oppressive devices appear in McMinn's complaint. For instance, McMinn alleged that MBF refused to declare dividends in contravention of the shareholders' agreement that all would share in the profits of the company, and that the controlling shareholders were paying themselves excessive salaries.

[4] {20} To address the use of such tactics, courts have imposed fiduciary duties on shareholders in close corporations similar to those owed by partners to one another. *See id.* ¶ 37. The relationship between shareholders in a close corporation is one of trust and confidence, and "majority action must be 'intrinsically fair' to minority interests." *Id.* (quoting *Fought v. Morris,* 543 So.2d 167, 171 (Miss.1989)); *see also Casey v. Brennan,* 344 N.J.Super. 83, 780 A.2d 553, 568 (Ct.App.Div.2001) ("[W]here ... a shareholder claim of unfairness involves a corporate transaction in which the directors stand to realize a personal benefit by continuing as shareholders after paying the minority an unfairly low price, we have no hesitancy in concluding that the fiduciary responsibilities of the directors and of the corporation toward all shareholders impose upon them the burden of proving the transaction was not 'unfair and inequitable' to plaintiffs."). Thus, the *Walta* court held that a controlling shareholder owed a non-controlling shareholder a fiduciary duty in efforts to restructure the corporation, including the purchase of the non-controlling shareholder's stock. 2002-

NMCA-015, ¶ 38, 131 N.M. 544, 40 P.3d 449. Further, the court held that breach of that fiduciary duty could be asserted as an individual claim separate from the remedies available under New Mexico's statutory corporate law for oppressive conduct. *Id.* Therefore, under *Walta,* McMinn's complaint stated a substantial claim for breach of fiduciary duties, regardless of the availability of an appraisal remedy due to the merger.

[5] {21} Adding a further layer of fiduciary responsibilities is the conflict of interest inherent in the cash-out merger designed by Sturges and Daniels, whereby they caused the original corporation to merge with a shell corporation also controlled by them and created for their benefit. Such conflict of interest***47** transactions are traditionally held up to careful scrutiny under fiduciary duty principles implicating the duty of loyalty. *See Mayeux v. Winder,* 2006-NMCA-028, ¶ 19, 139 N.M. 235, 131 P.3d 85 (noting that "the burden should be on the fiduciary to show proper dealings ... in [cases] involving transaction[s] that create[ ] a facial presumption of self-dealing"). "The general rule is that one acting in a fiduciary capacity for another has the burden of proving that a transaction with himself was advantageous for the person for whom he was acting." *Cleary v. Cleary,* 427 Mass. 286, 692 N.E.2d 955, 958 (1998) (quoted authority omitted); *see also Weinberger v. UOP, Inc.,* 457 A.2d 701, 710 (Del.1983) ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain."); Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law,* 84 Geo. L.J. 1, 45-46 (1995) ("[E]lsewhere in corporate law, conflicts traditionally have triggered stricter scrutiny than what is found in the current appraisal process.").

{22} With these fundamental principles of corporate law in mind, we now turn to New Mexico's appraisal statute and analyze whether it provides adequate scrutiny of conflict transactions and redress for conduct that breaches a fiduciary duty. The adequacy of the remedy is indicative of its intended scope. *See Sabella v. Manor Care, Inc.,* 1996-NMSC-014, ¶ 17, 121 N.M. 596, 915 P.2d 901 ("[T]he comprehensiveness or adequacy of the remedy provided is a factor to be considered in deciding whether a statute provides the exclusive remedies.").

New Mexico's Statutory Scheme

{23} The exclusivity provision contained in Section 53-15-3 must be considered in conjunction with the other relevant dissent and appraisal provisions, along with the purpose behind the statutory remedy. Quoted earlier and repeated here for convenience, the exclusivity provision states as follows:

A shareholder of a corporation who has a right under this section to obtain payment for his shares shall have no right at law or in equity to attack the validity of the corporate action that gives rise to his right to obtain payment, nor to have the action set aside or rescinded, except when the corporate action is unlawful or fraudulent with regard to the complaining shareholder or to the corporation.

Section 53-15-3(D). This language appears to limit a dissenting shareholder to an appraisal in the absence of fraud or illegality. However, putting aside the issue of whether MBF's conduct falls within the express exception in the statute, the language of the exclusivity provision itself is not the end of our inquiry. As this Court noted in *State ex rel. Helman v. Gallegos:*While ... one part of the statute may appear absolutely clear and certain to the point of mathematical precision, lurking in another part of the enactment, or even in the same section, or in the history and background of the legislation, or in an apparent conflict between the statutory wording and the overall legislative intent, there may be one or more provisions giving rise to genuine uncertainty as to what the legislature was trying to accomplish. In such a case, it is part of the essence of judicial responsibility to search for and effectuate the legislative intent-the purpose or object-underlying the statute.

117 N.M. 346, 353, 871 P.2d 1352, 1359 (1994).

{24} Reading the statutory scheme as a whole, our attention is drawn to Section 53-15-4(B), which offers some guidance in discerning the limits of the appraisal remedy and the types of transactions to which it was intended to apply. That provision sets forth the procedures that a dissenting shareholder electing to pursue the appraisal remedy must follow. The dissenting shareholder is required to file a written objection prior to or at the meeting at which the proposed merger is submitted to a vote, and then make a written demand on the surviving corporation for payment of the fair value of the dissenting shareholder's shares. Section 53-15-4(B) places certain limitations on the availability of the appraisal remedy:

*48 [i]f ... no demand or petition for the determination of fair value by a court has been made or filed within the time provided in this section, ...**then the right of the shareholder to be paid the fair value of his shares ceases and his status as a shareholder shall be restored, without prejudice, to any corporate proceedings which may have been taken during the interim.**

(Emphasis added.)

{25} Notably, the statute states that when a dissenting shareholder does not file a demand for fair value of his shares (appraisal), then the shareholder's right to an appraisal "ceases" and he is "restored" to his shareholder status. He does not have to accept whatever small sums the majority may choose to pay him for his shares. Instead, he may continue as a shareholder, a right which McMinn requested in this case and the majority refused. Therefore, appraisal and a buy-out is clearly not an exclusive remedy that the majority can arbitrarily impose upon the minority.

{26} However, removing the right to appraisal and restoring a dissenting shareholder to his former status, whereby he would be entitled to vote and exercise other rights of a shareholder, only makes sense when a merger takes place between two unrelated corporations. It does not make sense when the merger itself is designed to eliminate the non-controlling shareholder. *See* Thompson, *supra,* at 21 ("State legislatures' decisions to place the procedural burden on the minority seemed appropriate when the minority had the right to continue in the changed enterprise, but instead chose to retire.").

{27} Thus, a conflict is created if we were to apply the statutory language to the merger transaction undertaken by MBF. The purpose of the merger was to eliminate McMinn's interest in the company, but the statute provides that if McMinn did not file a demand for an appraisal, his rights as a shareholder should be restored. We now turn to an examination of the evolving purpose behind the appraisal remedy in order to shed light on this issue.

Purpose of the Appraisal Remedy

{28} The underlying purpose of the appraisal remedy has undergone a dramatic transformation in recent years in response to the changing nature of merger transactions. Historically, the appraisal remedy served a liquidity function. *See generally* Barry M. Wertheimer, *The Purpose of the Shareholders' Appraisal Remedy,* 65 Tenn. L.Rev. 661, 674 (1998). When the common law requirement of unanimous shareholder approval for fundamental corporate transactions began to be replaced by statutes allowing approval by a mere majority, the appraisal remedy evolved, allowing dissenting shareholders to demand cash for the fair value of their shares. *See Brown v. Arp & Hammond Hardware Co.,* 141 P.3d 673, 680 (Wyo.2006). "Once shareholders lost the right to veto fundamental changes, it was possible for shareholders to find themselves involuntarily holding an investment in an entity vastly different from the one originally contemplated." Wertheimer, *supra,* at 662. Appraisal statutes were designed to protect dissenting shareholders by allowing them a "way out" of an investment involuntarily altered by a fundamental corporate change. *See id.* at 663. The appraisal remedy thus served as a quid pro quo: in exchange for relinquishing their veto power, minority shareholders could dissent and receive cash for the fair value for their shares. *See HMO-W Inc. v. SSM Health Care Sys.,* 234 Wis.2d 707, 611 N.W.2d 250, 254 (2000).

{29} At the time appraisal rights became part of corporate statutes, there were substantial prohibitions on the use of mergers as a method of eliminating or "cashing out" minority shareholders. *See, e.g., Roland Int'l Corp. v. Najjar,* 407 A.2d 1032, 1034 (Del.1979) (stating that fiduciary duties are violated when "those who control a corporation's voting machinery use that power to 'cash out' minority stockholders, that is, to exclude them from continued participation in the corporate life, for no reason other than to eliminate them"), *overruled byWeinberger,* 457 A.2d 701; *In re Paine,* 200 Mich. 58, 166 N.W. 1036, 1038-39 (1918) (stating that it is not conceivable that the legislature intended statute to be used to drive out minority for *49 no better reason than majority wanted to acquire its interest); *Theis v. Spokane Falls Gaslight Co.,* 34 Wash. 23, 74 P. 1004, 1006 (1904) (concluding that dissolution was not proper if the only purpose was to get rid of disagreeable minority shareholders); Thompson, *supra,* at 18-20. Merger transactions typically involved unrelated corporations and were structured so that stock in the acquiring corporation was issued to shareholders of the acquired corporation. *See id.* "The procedures attendant to the appraisal process and the valuation standard reflected this more limited reach of majority power and of the appraisal remedy." *Id.* at 20.

{30} Today, however, financial and legal practices have shifted and mergers are often used solely to

eliminate minority shareholders. *See Pueblo Bancorporation v. Lindoe, Inc.,* 63 P.3d 353, 363 (Colo.2003). "This change in the use of fundamental corporate transactions requires a change in thinking about the purpose served by the appraisal remedy. The historic liquidity function of the remedy has diminished, and the remedy now serves a minority shareholder protection rationale, primarily in the context of cash out merger transactions." Wertheimer, *supra,* at 663. Despite these shifts in the nature of merger transactions and the exposure of non-controlling shareholders to oppressive conduct on the part of controlling shareholders, many jurisdictions, including New Mexico, have not revised their appraisal statutes to take into account the changing environment of corporate affairs. *See* Thompson, *supra,* at 28 ("The transformation of appraisal into a remedy for self-dealing does not easily fit with existing appraisal statutes."(footnote omitted)); *Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc.,* 532 A.2d 1324, 1335 (Del.Ch.1987) (holding that appraisal is not exclusive in non-arms length merger and expressing concern that majority stockholders not be allowed to "time or structure the transaction, or to manipulate the corporation's values, so as to permit or facilitate the forced elimination of the minority stockholders at an unfair price").

Appraisal is Not the Exclusive Remedy in This Case

[6] {31} MBF's use of a freeze out merger, particularly in the context of a closely-held corporation, has important implications for the appraisal remedy that, unfortunately, our statute does not address. As one commentator has observed:

> Too many of the current rules are carryovers from the earlier period when the primary risk of abuse in the appraisal proceeding was hold-ups by minority shareholders, which is the opposite of the risk in a squeeze-out situation in which majority shareholders with conflicts of interest are setting the terms of cash-out transactions..... Judges today assume that appraisal was intended as an exclusive alternative to fiduciary duty when that is not the way appraisal traditionally functioned nor is it the way current appraisal procedures permit today's remedy to function. The result is greater freedom for majority shareholders to direct the enterprise and less review of conflict of interest situations inherent in squeeze-out transactions.

Thompson, *supra,* at 54. *See* 2 F. Hodge O'Neal & Robert B. Thompson, *Close Corporations and LLCs: Law and Practice* § 9:5, at 9-22 to 9-23 (3d ed. 2004) ("The difficulty of valuing shares in a close corporation diminishes the usefulness of the appraisal remedy as a protection to minority shareholders."). New Mexico's appraisal statute appears to be designed to address arms-length merger transactions between two separate entities and does not seem to contemplate the type of conflict transaction at issue in this case. *See generally* Janet G. Perelson & James C. Compton, *1983 Amendments to the New Mexico Business Corporation Act and Related Statutes,* 14 N.M. L.Rev. 371, 383 (1984) (discussing 1983 amendments and noting that the appraisal remedy in Section 53-15-3 was designed to "preserve[ ] the right of the majority of shareholders to direct the management of the corporation, while respecting the desire of the dissenting shareholders not to participate in the corporate action").

{32} The exclusivity provision in the New Mexico Act, designed for arms-length mergers, is derived from Section 80 of the former Model Business Corporation Act ("MBCA"), ***50** which developed in a similar context. *See*§ 53-15-3 Compiler's notes. Responding to current needs, more recent amendments to the MBCA have expressly eliminated exclusivity of appraisal rights in conflict of interest transactions where the merging corporations are under common control. *See* MBCA § 13.02(d) (2003 amendments); Committee on Corporate Laws Report, *Changes in the Model Business Corporation Act Relating to Domestication and Conversion-Final Adoption,* 58 Bus. Law. 219, 289-90 (Nov.2002) (official comment discussing decision not to make appraisal exclusive in conflict of interest transactions). Section 53-15-3, in contrast, remains unchanged since 1983. Thus, our statute does not reflect legislative attention to the current dilemma in which controlling shareholders orchestrate a transaction to remove non-controlling shareholders, regardless of the non-controlling shareholders' desire to retain their interest in the company.

{33} Although our legislature has not updated New Mexico's corporations statutes, the revisions to the MBCA provide guidance in interpreting our current statutes. Those revisions are instructive as to the underlying purpose of the appraisal remedy, reflecting an intent that appraisal not be used to circumvent close scrutiny of conflict transactions or replace actions for breach of fiduciary duty. Other courts in similar situations have relied upon the MBCA to interpret their yet-unchanged statutes. *See Pueblo Bancorporation,* 63 P.3d at 368 (recent amendments to the MBCA prohibiting use of

marketability discounts in determination of fair value were persuasive to court when interpreting Colorado's appraisal statute, despite the lack of any amendments to the Colorado statute); *Brown,* 141 P.3d at 685 (same).

{34} Seen in this light, it now appears that the Court of Appeals may not have ascribed due importance to the distinction between the type of merger at issue here and a merger negotiated at arms-length between two unrelated corporations, not under common control. For instance, the Court of Appeals considered *Steinberg v. Amplica, Inc.,* 42 Cal.3d 1198, 233 Cal.Rptr. 249, 729 P.2d 683, 685 n. 3 (1986), as relevant authority on the issue of New Mexico's exclusivity provision, despite the fact that the court in *Steinberg* expressly limited its holding to mergers of two separate corporations not under common control or controlled by each other. *McMinn,* 2006-NMCA-049, ¶ 28, 139 N.M. 419, 133 P.3d 875. In so considering *Steinberg's* interpretation of California's "similarly worded" general exclusivity provision set forth in Cal. Corp.Code § 1312(a) (1990), the Court of Appeals was too dismissive of the fact that the California provision at issue in *Steinberg* would not have applied to the type of merger that occurred in this case. Indeed, California has an entirely separate provision for freeze out mergers, one that, unlike New Mexico's statute, expressly eliminates the right of appraisal for dissenting shareholders and subjects the merger transaction to a higher degree of scrutiny, similar to the entire fairness test set forth in *Weinberger,* 457 A.2d at 711, which we discuss in more detail later in this opinion. *See*Cal. Corp.Code § 1312(a), (b). Therefore, California's general exclusivity provision should not be used to interpret the application of New Mexico's exclusivity provision in this case.

[7] {35} As the Delaware Supreme Court observed in *Weinberger,* a breach of fiduciary duty case where the directors of the defendant corporations stood on both sides of the transaction, "the appraisal remedy ... may not be adequate in certain cases, particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved." 457 A.2d at 714. The Court of Appeals cited this same language from *Weinberger* in providing guidance for future litigants as to what types of conduct might fall within the statutory exception for fraud and unlawful conduct. *McMinn,* 2006-NMCA-049, ¶ 22, 139 N.M. 419, 133 P.3d 875. However, the merger at issue in this case involved some of those very issues of conflict of interest and self-dealing because Sturges and Daniels were the controlling shareholders and were on both sides of the transaction. *See*NMSA 1978, § 53-11-40.1A, B(2) ("[A] conflict of interest transaction is a transaction ... in which a director of the corporation has a ***51** direct or indirect interest," and stating that a director has an indirect interest if "another entity of which he is a director ... is a party to the transaction and the transaction is or should be considered by the board of directors of the corporation"); *Fought,* 543 So.2d at 170 ("[T]he use of the corporate process in the context of mergers designed to discount or remove the participation of the minority interest amounts to self-dealing in that the minority shareholder is denied the right to participate in the benefits of the corporation."). As mentioned previously, inherent in conflict transactions is the potential for abuse of the corporate process for the benefit of those in control. We decline to ascribe to our legislature an intent that would allow controlling shareholders in such situations to escape the close scrutiny typically accorded such transactions.

[8] {36} Further, even if the appraisal statute were to apply, the conduct alleged by McMinn on the part of MBF can also be said to fall within the express exception to the exclusivity provision for unlawful corporate actions. *See*§ 53-15-3(D). The *Walta* case, decided after the 1984 amendments to the New Mexico Corporations Act, recognized the fiduciary duties of shareholders in close corporations and set out the parameters within which shareholders must operate to satisfy the duties of good faith and loyalty. Oppressive conduct that breaches such fiduciary duties is unlawful under *Walta,* and therefore falls within the exception in the exclusivity provision for unlawful actions. *See Cohen v. Mirage Resorts, Inc.,* 119 Nev. 1, 62 P.3d 720, 729 (2003) (noting that "the term 'fraudulent,' as used in the Model Act, has not been limited to the elements of common-law fraud; it encompasses a variety of acts involving breach of fiduciary duties imposed upon corporate officers, directors, or majority shareholders"); *Smith v. N.C. Motor Speedway, Inc.,* 1997 WL 33463603, *6 (N.C.Super.Ct.1997) ("[T]he dissent and appraisal procedure does not provide the exclusive remedy where a transaction is determined to be 'unlawful or fraudulent,' and ... a breach of fiduciary duty is subsumed within these terms."). To hold otherwise would erase significant developments in New Mexico law on closely held corporations that took place in spite of the existence of the appraisal remedy and the exclusivity provision in Section 53-15-3. As discussed in the following section, controlling

shareholders in close corporations potentially could engage in oppressive tactics in breach of their fiduciary duties, and then escape liability for those actions simply by instituting an appraisal-triggering transaction to relegate minority shareholders to an appraisal proceeding for their shares.

Extinguishing Claims Arising Prior to Appraisal-Triggering Event

{37} Perhaps even more troubling than the prospect that exclusivity of appraisal will undermine the strict scrutiny of conflict of interest transactions is the possibility that appraisal will be used to extinguish legitimate claims based on director misconduct that occurred prior to the appraisal-triggering event. One commentator offers the following explanation of this problem:

[E]xclusivity may effectively extinguish shareholder claims alleging that director misconduct prior to the appraisal-triggering event resulted in the shares being devalued. This effect results if a court, because of the availability of appraisal, (1) refuses to entertain a claim based on director conduct other than the decision to engage in the appraisal-triggering event on particular terms, or (2) limits its inquiry in the process to finding the value of shares at the time of the appraisal-triggering event. If a court applies exclusivity in this way, claims will be extinguished even though the cash requested as damages in collateral actions is not a function of an alleged misvaluation decision by directors in setting the terms of the appraisal-triggering event, but rather compensation for the directors' separate, preappraisal misconduct. Moreover, the shareholder actions are lost notwithstanding the fact the court would have entertained the claim but for the fortuity of an intervening appraisal-triggering event.

Michelle M. Pepin, *Exclusivity of Appraisal-The Possibility of Extinguishing Shareholder Claims,* 42 Case W. Res. L.Rev. 955, 956 (1992); *see also Yanow v. Teal Indus.,**52 Inc., 178 Conn. 262, 422 A.2d 311, 322 n. 10 (1979) (noting that plaintiffs are not precluded from bringing "claims antecedent to and unrelated to the merger," notwithstanding statute expressly making appraisal the exclusive remedy). The instant case exemplifies this concern.

{38} Months before the directors of MBF conceived the plan of merger, McMinn had been complaining of the lack of a dividend policy and his belief that Daniels and Sturges were taking excessive salaries and failing to pay him his share of profits in contravention of the shareholders' agreement.[FN2] It cannot be disputed that these allegations would have supported an independent claim for breach of fiduciary duty had no merger transaction taken place. If we interpret the statutory appraisal remedy as McMinn's exclusive recourse in this case, his claims will be foreclosed. But the damages requested in his complaint were not simply a function of an alleged misvaluation decision by MBF in setting the terms of the merger, but rather on MBF's pre-merger misconduct. Furthermore, limiting McMinn to an appraisal valuation of the corporation after it allegedly had been depleted by the payment of excessive salaries to Sturges and Daniels would only reward the majority for its conduct and penalize the minority.

FN2. The only agreement between the original shareholders was an oral agreement that all would share in the profits of the company. This case highlights the importance of written buy-out agreements. Had there been such an agreement addressing how to deal with shareholders who were no longer employed by the company, then that agreement would control and there would have been no need to devise a merger to separate McMinn from the company. Our holding in this case represents a default position that will control in the absence of such an agreement.

{39} In a case like this, where controlling directors are alerted to allegations of a breach of fiduciary duty prior to considering a plan of merger, the institution of a merger transaction with no other purpose than to eliminate the non-controlling shareholder could be devised to relegate the complaining shareholder to an appraisal remedy in order to extinguish such claims. In such circumstances, the directors' conduct in designing the merger can itself be seen as a breach of fiduciary duty. Such conduct should not be permitted to go unscrutinized, and, if proven to breach a fiduciary duty, unredressed. *Fought,* 543 So.2d at 169 ("The traditional view that shareholders have no fiduciary duty to each other, and transactions constituting 'freeze outs' or 'squeeze outs' generally cannot be attacked as a breach of duty of loyalty or good faith to each other, is outmoded."). As the court in *Kademian v. Ladish Co.,* 792 F.2d 614, 630 (7th Cir.1986) observed, "the prospect that all shareholders will be paid off does not justify the corporation or its officers in acting unlawfully. The appraisal remedy cannot substitute for a suit for

breach of fiduciary duty or other torts." *See also Sealy Mattress Co.,* 532 A.2d at 1335 ("As fiduciaries seeking to 'cash out' the minority shareholders of a Delaware corporation in a non-arm's length merger, the defendants had a duty to be entirely and scrupulously fair to the plaintiffs in all respects.").

{40} We note that, had MBF not initiated the merger which it now claims relegates McMinn to an appraisal, it would not be able to object to a suit asserting the same claims asserted here. Further, in that case had the jury found, as it did here, that MBF had breached its fiduciary duties, then it could have awarded damages amounting to the fair value of McMinn's shares pursuant to *Walta. See also Int'l Telecharge, Inc. v. Bomarko, Inc.,* 766 A.2d 437, 441 (Del.2000) (noting in breach of fiduciary duty action by minority shareholders against CEO who merged corporation into another company controlled by him, shareholders were entitled to receive "at a minimum, what their shares would have been worth at the time of the Merger if [the CEO] had not breached his fiduciary duties" (quoted authority omitted)). Indeed, at trial in this case, McMinn presented expert testimony on the proper valuation of his shares, and the jury awarded him damages in that amount. On appeal, MBF did not contend that the verdict in McMinn's favor was unsupported by substantial evidence or that its own valuation of the company was fair to McMinn; rather, MBF argued simply that an appraisal was McMinn's exclusive remedy and that because he did not elect to pursue ***53** an appraisal, he was bound by the terms of the merger.

{41} Nothing in the appraisal statute indicates that cashed-out shareholders cannot pursue claims based on conduct antecedent or unrelated to the appraisal-triggering transaction itself. Further, the express exception in the statute for unlawful actions encompasses claims based on director misconduct that breaches a fiduciary duty. As we have said, if appraisal were the exclusive remedy for shareholders of closely-held corporations whose interests are cashed out in conflict of interest mergers, then the remedy would no longer serve its original purpose: to protect dissenting shareholders. What was designed as a shield to benefit minority shareholders who had lost their power to veto fundamental corporate transactions, would be transformed into a sword for majority oppression of the minority. Such a result is contrary to longstanding common law principles of fiduciary duty. *See Rosiny v. Schmidt,* 185 A.D.2d 727, 739, 587 N.Y.S.2d 929 (N.Y.App.Div.1992) (noting "the longstanding principle that where a fiduciary relationship exists between parties, transactions between them are scrutinized with extreme vigilance ..." (quoted authority omitted)). We decline to interpret the appraisal statute in a manner that would undermine those principles and the New Mexico case law that has developed in this area since the last time the statute was amended.

The Delaware Approach to Exclusivity

{42} Though there is certainly no uniformity among jurisdictions addressing exclusivity of the appraisal remedy, several other states have interpreted their statutes to allow for breach of fiduciary duty claims outside of an appraisal proceeding. *See Mullen v. Academy Life Ins. Co.,* 705 F.2d 971, 973 (8th Cir.1983) (noting that a developing body of case law and commentary suggests that "majority stockholders owe minority stockholders a fiduciary duty which is independent of statute and which may be enforced in an action other than a statutory [appraisal] proceeding"); *IRA for Benefit of Oppenheimer v. Brenner Cos.,* 107 N.C.App. 16, 419 S.E.2d 354, 357 (1992) ("[A] statutory appraisal is not a dissenting shareholder's exclusive remedy when the shareholder has presented claims of breach of fiduciary duty, fraud, self-dealing, securities violations, or similar claims based on allegations other than solely the inadequacy of the stock price."). Most persuasive to us is the approach taken by the courts in Delaware,[FN3] which several other states have followed, Delaware being widely recognized as "the fountainhead of American corporations" whose courts "are known for their expert exposition of corporate law." *In re Ivan F. Boesky Sec. Litig.,* 129 F.R.D. 89, 97 (S.D.N.Y.1990); *see also IBS Fin. Corp. v. Seidman & Assocs.,* 136 F.3d 940, 949-50 (3d Cir.1998) ("When faced with novel issues of corporate law, New Jersey courts have often looked to Delaware's rich abundance of corporate law for guidance."); *Connolly v. Agostino's Ristorante, Inc.,* 775 So.2d 387, 388 n. 1 (Fla.Dist.Ct.App.2000) (noting that "[t]he Florida courts have relied upon Delaware corporate law to establish their own corporate doctrines" (quoted authority omitted)); *Hilton Hotels Corp. v. ITT Corp.,* 978 F.Supp. 1342, 1346 (D.Nev.1997) ("Where ... there is no Nevada statutory or case law on point for an issue of corporate law, this Court finds persuasive authority in Delaware case law."); *Jacobson v. Am. Tool Cos.,* 222 Wis.2d 384, 588 N.W.2d 67, 73 (Ct.App.1998) (relying on Delaware case law, and *Weinberger* specifically, to define fiduciary duty principles).

FN3. Though the Delaware appraisal statute does not have an express exclusivity provision, Delaware case law provides a comprehensive analysis of the scope of the appraisal remedy. That analysis is not incompatible with the New Mexico statute, which contains both an apparent ambiguity when applied to freeze out mergers, and an express exception for fraudulent or unlawful conduct. *See Krieger v. Gast,* 122 F.Supp.2d 836, 844 (W.D.Mich.2000) (noting that "there is [no] significant difference between the scope of the appraisal remedy under Delaware law and the law of other states, because most states, even those whose statutes expressly provide that the appraisal remedy is exclusive, recognize an exception at least for fraud, and in many cases 'unlawful' action").

{43} *Weinberger* is the seminal Delaware case on exclusivity of appraisal. As noted previously, the Delaware Supreme Court in ***54** that case recognized that the appraisal remedy may not be adequate in cases involving director misconduct. Thus, the court held that the exclusivity of an appraisal action is conditional and may be invoked when the disagreement is only over whether to accept an otherwise legitimate merger offer. *See Weinberger,* 457 A.2d at 714 (appraisal remedy is exclusive when the only allegation is that the directors have failed to appropriately determine the cash value of the shares); *Stauffer v. Standard Brands Inc.,* 187 A.2d 78, 80 (Del.1962) (cited by *Weinberger* for holding that appraisal is exclusive when the "real relief sought is the recovery of the monetary value of plaintiff's shares" and the dispute reduces to nothing but a difference of opinion as to value). Claims challenging wrongful behavior other than incorrect, accounting-type share valuation should not be forced into an appraisal. *See* Pepin, *supra,* at 969 (noting that "[t]he appraisal statute sets forth the procedure by which a dissenting shareholder can adjudicate the value of his shares" and "[i]f valuation of these shares is not at issue, then the availability of the appraisal process is of little significance").

{44} Further, in the view of the Delaware courts, even if a claim challenges director decision-making related to valuation of shares, that claim will not be precluded by appraisal if such decision-making was accompanied, as it was here, by a conflict of interest. *See, e.g., Nagy v. Bistricer,* 770 A.2d 43, 50-51 (Del.Ch.2000) (noting claim that merger was a self-dealing transaction between corporations controlled by same directors designed to advantage their personal interests at the expense of cashed-out shareholder stated "substantial claim[ ] for breach of fiduciary duty unrelated to judgmental factors of valuation" (quoted authority omitted)); *Weinberger,* 457 A.2d at 714 (noting that the appraisal remedy may not be adequate in cases that involve self-dealing). Delaware subjects conflict-of-interest transactions, such as the merger at issue in this case, to judicial review for entire fairness, with the burden resting on the controlling shareholders who stand on both sides of the transaction to establish the entire fairness of the transaction, both in terms of fair dealing and fair price. *See Weinberger,* 457 A.2d at 710-11. If the controlling shareholders cannot sustain this burden, then the transaction amounts to a breach of fiduciary duty. *See, e.g., Delaware Open MRI Radiology Assocs. v. Kessler,* 898 A.2d 290 (Del.Ch.2006). Pursuant to *Weinberger* and its progeny, "[i]t is not unusual [in Delaware] for the same merger to be challenged in a statutory appraisal action and in a separate breach of fiduciary duty damage action." *M.G. Bancorporation, Inc. v. Le Beau,* 737 A.2d 513, 520 (Del.1999).

{45} We find the Delaware approach instructive, based upon its reasoning and the experience of its courts in matters of corporate law. Accordingly, for all the reasons stated herein, we hold that the New Mexico appraisal remedy was not intended to replace common law actions for breach of fiduciary duty. Given the conflict created by the language of our appraisal statutes, the purpose of the appraisal remedy, the nature of MBF as a close corporation, and the particular acts of misconduct alleged by McMinn in this case, the trial court correctly allowed McMinn to proceed with his breach of fiduciary duty suit, regardless of the existence of the appraisal remedy.

MBF's Arguments

{46} MBF asserts that because McMinn sought only compensatory damages amounting to the fair value of his shares and because McMinn's expert testified to the proper method of valuing those shares, McMinn's complaint was essentially that he was not paid fair value for his stock and thus an appraisal proceeding was the exclusive remedy. However, the dispute cannot be defined by the remedy sought. *See Berger v. Intelident Solutions, Inc.,* 911 A.2d 1164, 1172 (Del.Ch.2006) (rejecting "rigid" New York approach

that holds appraisal to be exclusive if primary relief sought is monetary); *Delaware Open MRI Radiology Assocs.,* 898 A.2d at 344 (stating remedy for breach of fiduciary duty was same as amount determined to be fair value in appraisal). As the dissenting justice in *Stepak v. Schey,* 51 Ohio St.3d 8, 553 N.E.2d 1072, 1079 (1990) observed, "dissatisfaction with the price paid does not automatically convert the action to a simple ***55** demand for the 'fair cash value' of a stockholder's shares."

[9] {47}*Walta* indicates that the proper remedy in a breach of fiduciary duty action involving the squeeze-out of a non-controlling shareholder in a close corporation is compensatory damages measured by the fair value of the former shareholder's shares. 2002-NMCA-015, ¶ ¶ 28, 66, 131 N.M. 544, 40 P.3d 449. The jury having found that McMinn proved misconduct on the part of MBF, McMinn was entitled to damages in the amount of the value of his shares, determined by proper valuation methods and taking into account any devaluation worked by MBF's misconduct.

{48} MBF also argues that McMinn has pointed to no authority that he could not have presented evidence of breach of fiduciary duty in an appraisal proceeding, to the extent those claims were related to the fair value of the company. However, neither does MBF point to any binding authority that McMinn *could* have presented such evidence in an appraisal proceeding. Indeed, MBF's counsel conceded that, had McMinn elected to pursue an appraisal, MBF would have argued that breach of fiduciary duty claims are not properly considered in an appraisal action and that lost profits could not be included in the determination of "fair value."

{49} The New Mexico statute does not define "fair value" and is silent on what types of claims can be litigated and how fair value should be calculated in an appraisal proceeding.[FN4] Courts addressing exclusivity of the appraisal remedy in other states have come up with a number of disparate approaches to whether claims for breach of fiduciary duty can be considered within an appraisal action. Thus, case law from other jurisdictions does not point out a clear path on that issue.

> FN4. Though the current New Mexico statute does not define "fair value," revisions to the Model Act now provide that "fair value" is the value of the corporation's shares determined:
>
> (i) immediately before the effectuation of the corporate action to which the shareholder objects;
> (ii) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and
> (iii) without discounting for lack of marketability or minority status....
>
> MBCA § 13.01. Wells' report did not comport with any of these guidelines. The value of McMinn's shares was determined not from the time of the merger, but from the time he resigned his employment with MBF. Wells did not use any of the three valuation techniques prescribed by New Mexico law. *See Tome Land & Imp. Co. v. Silva,* 83 N.M. 549, 552, 494 P.2d 962, 965 (1972) ("In arriving at the fair value of the shares of the dissenting stockholders, the courts have been almost unanimous in using a combination of three elements of valuation: (1) Net asset value; (2) market value; and (3) investment or earnings value."). And, MBF applied a minority discount to McMinn's shares. *See, e.g., Cavalier Oil Corp. v. Harnett,* 564 A.2d 1137, 1144 (Del.1989) (marketability discounts and minority discounts are not to be applied in an appraisal because the "objective of [a statutory appraisal] is to value the corporation itself, as distinguished from a specific fraction of its shares as they may exist in the hands of a particular shareholder").

{50} Some courts have interpreted their statutes to provide for an appraisal remedy that takes director misconduct into account in valuing dissenting shareholders' shares. *See, e.g., Bingham Consolidation Co. v. Groesbeck,* 105 P.3d 365, 374 (Utah Ct.App.2004) (dissenting shareholders' two separate actions, one for appraisal and one seeking compensatory and punitive damages, were properly consolidated into a single appraisal proceeding "because the core of [the shareholders'] action [was] to recover only that increment of value lost due to [the corporation's] self-dealing"); *HMO-W, Inc.,* 611 N.W.2d at 259 (court may consider evidence of unfair dealing as it affects the value of a dissenter's shares); *Bomarko v. Int'l Telecharge, Inc.,* 1994 WL 198726, at *2 ("[B]reach of fiduciary duty claims that do not arise from the merger are corporate assets that may be included in the determination of fair value."). Other authority suggests that evidence of breach of

fiduciary duty and concomitant damage awards are not appropriate in appraisal proceedings. *See, e.g., Sieg Co. v. Kelly,* 568 N.W.2d 794, 802 (Iowa 1997) (holding that "the narrow remedy provided by an appraisal action does not encompass claims of fraud, self-dealing or breach of fiduciary duty" and that "any claim of breach of fiduciary duty must be ***56** presented in a separate action" because "it is not appropriate to consider it in [an appraisal proceeding]"); *Armstrong v. Marathon Oil Co.,* 32 Ohio St.3d 397, 513 N.E.2d 776, 798 (1987) (causes of action seeking compensation other than the value of dissenter's shares are not foreclosed by appraisal, but such causes of action may not be joined with the appraisal proceeding and must be brought separately). At the time McMinn filed his suit, there was no New Mexico authority allowing consideration of breach of fiduciary duty claims in appraisal proceedings.

{51} The current language of the statute does not appear to allow for consideration of anything beyond "fair value" in an appraisal. Such an action has a "limited purpose and focus," with the only litigable issue being "the determination of the value of the appraisal petitioners' shares on the date of the merger." *Nagy,* 770 A.2d at 52. Without further elaboration by the legislature, we will not expand the appraisal remedy beyond the clear language of the statute. Appraisal serves a limited accounting function for arms-length mergers and is exclusive in that realm only. Therefore, we hold that Section 53-15-3 does not provide the exclusive remedy for freeze out mergers accompanied by conflicts of interest or allegations of misconduct.

FIDUCIARY DUTY OF THE CORPORATION

[10] {52} MBF contends that exclusivity in this case turns on the fact that the individual directors were dismissed and McMinn's breach of fiduciary duty case proceeded against the corporation alone. MBF argues that McMinn's allegations that he was deprived of profits in contravention of the shareholders' agreement and that Sturges and Daniels paid themselves excessive salaries will only support a breach of fiduciary duty claim against Sturges and Daniels individually. The Court of Appeals apparently relied on this distinction between the corporation and the individual directors in determining exclusivity, stating that it was "only considering whether the appraisal remedy is the exclusive remedy in a suit against the corporation for breach of fiduciary duty." *McMinn,* 2006-NMCA-049, ¶ 35, 139 N.M. 419, 133 P.3d 875. The Court of Appeals did not decide "whether and under what circumstances a dissenting shareholder may have a common law claim against the majority shareholders or the officers and directors." *Id.*

{53} While the distinction between the individual directors and the corporate entity might have relevance to the question of exclusivity of the appraisal remedy, in this case we treat the two as one and the same because that distinction was not made in the trial court and the case was not presented to the jury in that way. Instead, the court instructed the jury as follows:

Every ***corporation*** has a fiduciary duty to its shareholders. Fiduciary duty requires ***the corporation*** to act candidly to disclose material facts and to deal openly, honestly and fairly with its shareholders. This duty also includes the duty of loyalty and a duty to avoid self-seeking and self-dealing conduct.

A corporation can only act through its ... officers and employees....***Any act or omission of an officer or of any employee of a corporation within the scope of his employment is an act or omission of the corporation.***

(Emphasis added.) Although MBF now suggests that a corporation does not owe fiduciary duties to its shareholders, MBF did not object to this instruction or to McMinn's counsel's closing argument applying this theory. Further, MBF's counsel, in discussing how to instruct the jury on fiduciary duty, stated that "all parties admit that there was a fiduciary duty running both ways. There isn't even any issue." These admissions along with the jury instructions are now law of the case and, for purposes of this appeal, we treat the fiduciary duties owed by Sturges and Daniels and those owed by MBF as one and the same. *See Couch v. Astec Indus., Inc.,* 2002-NMCA-084, ¶ 40, 132 N.M. 631, 53 P.3d 398 ("Jury instructions not objected to become the law of the case.").

CONCLUSION

{54} Whether we say that the exclusivity provision in Section 53-15-3 does not apply ***57** to the merger transaction in this case because of the potential conflict of interest or that the exception to the exclusivity provision applies because of the nature of the close corporation and the extinguishment of prior claims, McMinn was not foreclosed from seeking compensatory damages for breach of fiduciary duty

and electing not to pursue an appraisal. The Court of Appeals did not address McMinn's claims on appeal because it found that appraisal was the exclusive remedy. Because we now hold that appraisal was not McMinn's exclusive remedy, we remand to the Court of Appeals to consider McMinn's claims on appeal.

{55}**IT IS SO ORDERED.**

WE CONCUR: EDWARD L. CHÁVEZ, Chief Justice, PATRICIO M. SERNA, and PETRA JIMENEZ MAES, Justices, CELIA FOY CASTILLO, Judge (sitting by designation).
N.M.,2007.
McMinn v. MBF Operating Acquisition Corp.
142 N.M. 160, 164 P.3d 41, 2007 -NMSC- 040

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COURT OF APPEALS
THE STATE OF WASHINGTON
DIVISION I

SOUND INFINITI, INC., d/b/a, et al.,	
Appellant/Cross-Respondent,	No. 59477-0-I
v.	**PROOF OF SERVICE**
RICHARD M. SNYDER et ux., et al,	
Respondents/Cross-Appellants.	

The undersigned certifies under penalty of perjury under the laws of the State of Washington that on the 13th day of November, 2007, I caused to be placed with a legal messenger service, for delivery on the same day, copies of the following documents:

- Brief of Appellant/Cross-Respondent;
- Copy of Appellant's Supplemental Designation of Clerk's Papers; and
- Proof of Service

addressed as follows:

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Mark L. Gannett

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